Proposed FASB Staff Position No. FAS 141(R)-a, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination that Arise from Contingencies (File Reference: proposed FSP FAS 141(R)-a)

Dear Mr. Golden:

We appreciate the opportunity to comment on the Financial Accounting Standards Board’s (the Board or FASB) proposed FASB Staff Position No. FAS 141(R)-a, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination that Arise from Contingencies (the proposed FSP). We commend the Board for its efforts to address the implementation issues that arose from the changes to the recognition and measurement requirements made by FASB Statement No. 141(R), Business Combinations (Statement 141(R)), for assets acquired and liabilities assumed in a business combination that arise from contingencies (hereafter referred to as pre-acquisition contingencies). We generally agree with the changes to the initial recognition and measurement requirements for pre-acquisition contingencies in the proposed FSP. We also believe that the Board’s decision to provide further guidance regarding when the fair value of a pre-acquisition contingency can be reasonably determined will assist constituents in the application of the requirements of the proposed FSP, although we expect the subjectivity of the determination of whether fair value can be reasonably determined for specific pre-acquisition contingencies to result in significant debate among preparers, auditors and regulators. We do, however, have concerns about certain aspects of the proposed FSP described below.

Subsequent measurement of pre-acquisition contingencies

We believe that a consistent initial and subsequent measurement model for pre-acquisition contingencies would be more conceptually sound and easier to apply in practice than the mixed measurement model enumerated in the proposed FSP (and illustrated in rather complex flowcharts). To achieve a consistent measurement model, we would propose that those pre-acquisition contingencies be subsequently measured on the same basis as the initial measurement. As a result, pre-acquisition contingencies that initially are recognized at fair value would continue to be measured at fair value in subsequent periods. Similarly, pre-acquisition contingent liabilities that are initially recognized in accordance with FASB Statement No. 5, Accounting for Contingencies, would continue to be measured in accordance with Statement 5 in subsequent periods. Finally, contingent assets measured at the best estimate of the settlement amount would continue to be remeasured on that
basis. Our view on subsequent measurement is similar to the Alternative View presented in the proposed FSP.

Paragraphs 20 and 21 of the proposed FSP provide the subsequent measurement model for pre-acquisition contingent liabilities that were initially measured at acquisition-date fair value (in instances when the acquirer is neither released from risk nor fulfills its obligation over time). The model for subsequent measurement in the proposed FSP indicates that, upon obtaining new information regarding the potential outcome of the pre-acquisition contingency, the acquirer must remeasure the pre-acquisition contingency at the higher of its acquisition-date fair value or the amount that would be recognized if the acquirer applied the provisions of Statement 5. The proposed FSP further clarifies that, once a pre-acquisition contingency is remeasured at a Statement 5 amount, the acquirer should continue to apply the provisions of Statement 5 for all subsequent measurements. If the Statement 5 measurement is never higher than the acquisition-date fair value, then the pre-acquisition contingency is not remeasured until one of the conditions in paragraph 20(a)-(c) of the proposed FSP are met. In addition to the complexity of applying such a model, the approach provides anomalous results in that the subsequent measurement for pre-acquisition contingencies differs in the situations even though the subsequent Statement 5 measurement amount is the same. For example, consider the following two scenarios:

- The pre-acquisition contingent liability is initially measured at its fair value of $100, is subsequently remeasured to its Statement 5 value of $120 upon the receipt of new information, and then later is remeasured to a new Statement 5 measurement of $80.

- The pre-acquisition contingent liability is initially measured at its fair value of $100 and subsequently new information is received, at which time the Statement 5 measurement is $80. However, because the Statement 5 value never exceeded the initial fair value, the liability is not remeasured to $80.

Similar issues and anomalies arise from pre-acquisition contingent assets that are measured at estimated future settlement amount, which subsequently are remeasured at the lower of the amount recognized at the acquisition date and the estimated future settlement amount when new information is obtained about the possible outcome of the contingency.

We believe that the alternative approach described in the second paragraph of our letter results in a conceptually superior measurement that is easier to apply and understand and does not provide for the anomalous results illustrated above for contingent liabilities. While we understand that many have concerns about remeasuring pre-acquisition contingencies at fair value, we believe that because only a limited number of pre-acquisition contingencies will be initially measured at fair value (and only if the fair value is reasonably estimable), the difficulties of such remeasurement will be limited.

**Contingent consideration from previous acquisitions by the acquiree**

We disagree with the Board's conclusion that an acquiree's previously existing contingent consideration arrangements are subject to the contingent consideration model in paragraphs 41, 42, and 65 of Statement 141 (R). We believe that such arrangements are pre-acquisition contingencies and should be subject to the pre-acquisition contingency model. In paragraph 3 of Statement
141(R), contingent consideration is defined as "an obligation of the acquirer to transfer additional assets or equity interests to the former owners of an acquiree as part of the exchange for control of the acquiree if specified future events occur or conditions are met." It is unclear to us how a contingent payment obligation of the acquirer to a third party separate from the business combination being accounted for meets the definition of contingent consideration (it is not an obligation to the parties that sold the business to the acquirer, and could involve a transaction several times removed from the current acquisition).

We believe that one of the fundamental concepts underlying Statement 141(R) is that the measurement and recognition of assets and liabilities acquired or assumed from the acquiree do not depend on the circumstances under which the asset was acquired or the liability was assumed. Whether the contingent liability of the acquiree arose from an asset acquisition, a business combination, or some other commercial arrangement should not affect the manner in which the acquirer measures or recognizes the liability. In other words, we do not believe the previous accounting for the acquiree's business combination should affect the acquirer's accounting for any resulting assets or obligations (e.g., goodwill).

Disclosure of pre-acquisition contingencies

We also have concerns about disclosures required by the proposed FSP. We understand that the disclosure requirements in the proposed FSP are less extensive than those required by Statement 141(R); however, we are concerned with the different disclosure requirements that would apply to pre-acquisition contingencies as compared to other contingencies that are not acquired or assumed in a business combination. For example, we disagree with the requirement to disclose a change in the range of expected outcomes without any provision that allows an entity to omit those disclosures if the range is not reasonably estimable. We believe that this information may prove difficult to obtain for some pre-acquisition contingencies and, even if obtained, may not be auditable. It is also unclear to us why there is a requirement to disclose a change in the range of reasonably possible outcomes for unrecognized pre-acquisition contingencies, but there is no requirement to disclose the range of reasonably possible outcomes as of the acquisition date.

While there may be some additional pre-acquisition contingencies measured at fair value based on the provisions of the proposed FSP as compared to those recognized under FASB Statement No. 141, Business Combinations, we believe that the language in the proposed FSP will be subject to differing interpretations and may result in a significant majority of pre-acquisition contingencies being measured in accordance with the provisions of Statement 5. While Statement 5 requires disclosure of the range of expected outcomes in certain circumstances, it does not require such disclosure if the range is not reasonably estimable. Additionally, Statement 5 requires the disclosure of amounts recognized for contingencies only if failure to provide such disclosure would make the financial statements misleading.

In paragraph C24 of the proposed FSP, the Board concludes that disclosure beyond what is required by Statement 5 should not be required, in part due to the concerns about providing prejudicial information. However, there is no exemption from disclosure in the proposed FSP if providing such disclosure would be prejudicial, and incremental disclosures beyond those required by Statement 5 do appear to be required by the proposed FSP. We believe that this lack of an exemption for
prejudicial information will lead to the same concerns that were expressed during the deliberations of the Board’s Statement 5 project.

Given that the Board already has an active project on its agenda to reconsider the disclosure requirements for contingencies, we believe that it would be inappropriate to require disclosures for pre-acquisition contingencies acquired or assumed in business combinations that are different from those required for other contingencies. We believe that an appropriate alternative is to (1) reference the disclosures already required by Statement 5 (for contingencies measured at the Statement 5 amount or estimated future settlement amount) and Statement 157 (for contingencies measured at fair value) for periods subsequent to the business combination, if the Board accepts the Alternative View; or (2) require the disclosures in the proposed FSP only for those pre-acquisition contingencies that are initially measured at fair value, with all pre-acquisition contingencies initially measured in accordance with Statement 5 (or at estimated future settlement amount) subject to that Statement’s disclosure requirements.

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We would be pleased to discuss our comments with the Board or its staff at your convenience.

Very truly yours,

Ernst & Young LLP