



Grant Thornton



LETTER OF COMMENT NO. 14

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Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Audit • Tax • Advisory

Grant Thornton LLP
175 W Jackson Boulevard, 20th Floor
Chicago, IL 60604-2687
T 312.856.0200
F 312.565.4719
www.GrantThornton.com

Via Email to director@fasb.org

Re: File Reference: Proposed FSP FAS 141(R) - a

Dear Mr. Golden,

Grant Thornton LLP appreciates the opportunity to comment on the proposed FASB Staff Position FAS 141(R) – a, “Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies.” We support the issuance of a final FSP to address concerns that have arisen about the accounting for assets and liabilities arising from contingencies under FASB Statement 141(revised 2007), *Business Combinations*. We believe that the proposed guidance would be more operational than the exiting provisions of Statement 141(R), but that the proposed guidance should be clarified as indicated in our responses to the following questions posed in the proposed FSP’s Notice to Recipients.

Question 1

Will the proposed FSP meet the project’s objective to improve financial reporting by addressing application issues identified by preparers, auditors, and members of the legal profession about Statement 141(R) related to the initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination? Do you believe the amendments to Statement 141(R) in the proposed FSP are necessary, or do you believe the current requirements in Statement 141(R) should be retained?

We support the proposal to replace the initial measurement and recognition guidance in Statement 141(R) on assets and liabilities arising from contingencies with guidance similar to that in Statement 141, *Business Combinations*, on preacquisition contingencies. We believe that such a change would address concerns that have arisen about the existing requirements in Statement 141(R). However, we believe that the proposed guidance in paragraph 14 of the FSP should be clarified as indicated in the following discussion.

- Measurement criteria. The meaning of *a similar amount for assets* in paragraph 14 (and in the proposed addition of paragraph 24C to Statement 141(R)) may not be clear. We believe that the proposed guidance could be understood to refer to the amount that would be

recognized for assets in accordance with FASB Statement 5, *Accounting for Contingencies*. That amount would likely be zero because gain contingencies are usually not recognized under paragraph 17 of Statement 5.

- Recognition threshold. Although the measurement criteria in paragraph 14 refer to Statement 5, the recognition criteria do not. Therefore, it may not be clear whether the term *probable* refers to the recognition threshold for a loss contingency in accordance with Statement 5 or to the application of the definition of assets and liabilities in FASB Concepts Statement 6, *Elements of Financial Statements*. The distinction could be significant. As noted in paragraph C7 in the proposed FSP's basis for conclusion, "Attorneys indicated that if an acquirer recognizes a liability for a contingency because it has concluded that it is more likely than not that a liability exists under Concepts Statement 6, the acquirer could be perceived as admitting guilt (even though the law may be highly uncertain in the relevant area). The result could be prejudicial to the acquirer."

We suggest revising the guidance in proposed paragraph 14 in the FSP, and in the proposed amendments to paragraph 24 of Statement 141(R), to be more consistent with paragraph 40 and footnote 15 of Statement 141. Such revisions could clarify that both the measurement and recognition criteria for the assets and liabilities arising from contingencies should be applied by analogy to the guidance in paragraph 8 of Statement 5 on loss contingencies rather than to paragraph 17 on gain contingencies. In addition, footnote 15 in Statement 141 provides a general description of the measurement guidance in Interpretation 14, *Reasonable Estimation of the Amount of a Loss*, in a manner that is not limited to the measurement of a contingent loss. Therefore, we suggest that the Board consider revising proposed paragraph 14 of the FSP as follows (paragraph 14, marked for suggested revisions):

14. If the acquisition-date fair value of an asset acquired or a liability assumed in a business combination that arises from a contingency cannot be reasonably determined during the measurement period, the acquirer shall ~~recognize~~ ~~measure~~ that asset or liability ~~at the amount that would be recognized for liabilities in accordance with Statement 5 and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*, and a similar amount for assets (hereafter referred to as "future settlement amount"). An asset or liability measured at its future settlement amount shall only be recognized~~ as of the acquisition date if both of the following conditions are met prior to the end of the measurement period:

- a. Information available prior to the end of the measurement period indicates that it is probable that an asset existed or a liability had been incurred at the acquisition date. ~~and if the future settlement amount of the asset or liability can be reasonably estimated.~~ It is implicit in this condition that it must be probable at the acquisition date that one or more future events will occur confirming the existence of the asset or liability.
- b. The ~~future settlement~~ amount of the asset or liability can be reasonably estimated.

The amount that would be measured and recognized in accordance with this paragraph is referred to as the future settlement amount of the asset or liability. The measurement and recognition criteria of this paragraph shall be applied using the guidance provided in Statement 5 and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*, for application of the similar criteria in paragraph 8 of Statement 5. Interpretation 14 specifies the amount to be recognized if the reasonable estimate of the amount is a range. If some amount within the range appears at the time to be a better estimate than any other amount within the range, that amount is recognized. However, if no amount within the range is a better estimate than any other amount, then the minimum amount in the range is recognized. at the amount that would be recognized for liabilities in accordance with Statement 5 and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*, and a similar amount for assets (hereafter referred to as “future settlement amount”).

Question 2

In developing this proposed FSP, the Board decided to adopt a model that is similar to the requirements in FASB Statement No. 141, Business Combinations. However, the Board decided to provide additional guidance for assessing whether the fair value of an asset or liability arising from a contingency can be reasonably determined. A additionally, the Board decided to provide subsequent accounting guidance for assets or liabilities arising from contingencies initially recognized at fair value, which was not provided in Statement 141. Do you agree with the Board’s decision to provide this additional guidance, or do you believe the proposed FSP should carry forward the requirements in Statement 141 without reconsideration, including not addressing subsequent measurement and accounting? Alternatively, do you believe the proposed FSP should require that the initial and subsequent measurement of assets and liabilities arising from contingencies in a business combination be on the same basis (that is, assets and liabilities arising from contingencies initially recognized at fair value should subsequently be remeasured at fair value)?

We support the proposed guidance on the subsequent accounting for assets and liabilities arising from contingencies that are recognized as of the acquisition date, with certain clarifications.

Paragraphs 23 and 24 of the proposed FSP would require the amount recognized as of the acquisition date for assets arising from contingencies to be adjusted only when new information is obtained about the possible outcome of the contingency. However, as of the acquisition date, the acquirer may know the expiration date of a contingent right or may know that the asset would be collected over time. Under the proposed guidance, it may not be clear whether such information about the expiration or settlement of a contingency, if known at the acquisition date, could be considered “new” information allowing for the subsequent derecognition of any of the acquisition date amount. We suggest that the final FSP clarify that the asset should be derecognized as the acquirer collects it, sells it, or otherwise loses the right to it. This would be consistent with the proposed FSP’s basis for conclusions, paragraph C21, which states, “this FSP does not make any changes to the subsequent measurement and

accounting guidance in Statement 141(R) for assets arising from contingencies recognized at fair value.”

Question 3

What costs do you expect to incur or not incur if the Board were to issue this proposed FSP in its current form as a final FSP? How could the Board further reduce the costs of applying the requirements without significantly reducing the benefits?

This is a question best addressed by financial statement preparers.

Question 4

Do you believe the guidance in paragraphs 10–13 provides clear guidance for assessing when fair value can be reasonably determined? If not, please explain what additional guidance is necessary.

We believe the proposed guidance on measuring fair value is sufficient.

Question 5

Constituents have raised concerns about liabilities arising from contingencies being recorded indefinitely when there is no clear resolution of the contingency because the acquirer does not believe settlement will ever be required and the liability is not subject to cancellation or expiration. Will the proposed amendment to Statement 141(R) that allows for the derecognition of a liability arising from a contingency when new information is obtained that indicates it has become remote that the obligation will be enforced address these concerns? Do you believe this guidance is operational?

We support the issuance of the proposed guidance on the subsequent accounting for liabilities arising from contingencies recognized as of the acquisition date. We believe that it would address concerns raised about the exiting derecognition requirement in Statement 141(R).

Question 6

Although not clear, the Board did not intend the subsequent measurement and accounting guidance in Statement 141(R) to require that a liability arising from a contingency be recorded at its acquisition-date fair value until the contingency is completely resolved in cases where the acquirer is released from risk over time or the acquirer fulfills its performance obligation over time. Do you believe the clarifying guidance included in this proposed FSP is operational for the subsequent measurement and accounting of a liability initially recognized at fair value?

Yes.

Question 7

Do you believe the revised disclosure requirements in this proposed FSP sufficiently protect sensitive information while providing users with useful information about contingencies arising from a business combination?

Disclosure of sensitive information

The ability to aggregate disclosures for contingencies that are similar in nature would protect sensitive information only if the acquirer has contingencies of a similar nature to aggregate.

Clarification of disclosure requirements for unrecognized contingencies

The disclosure requirements in paragraph 27 of the proposed FSP for unrecognized contingencies need to be clarified.

- Paragraph 27 would require disclosures “for each period after the acquisition date until the asset and liability arising from a contingency is *derecognized in full*.” (Emphasis added.) Because only a recognized asset or liability can be subsequently derecognized, the guidance on when the paragraph 27 disclosures should be made can only apply to recognized assets to liabilities. However, paragraph 27(a) would also require disclosure of any changes in the range of outcomes for unrecognized assets and liabilities arising from contingencies. Because paragraph 27, as drafted, would only require disclosures for periods until a recognized asset or liability has been derecognized, it is not clear when, if ever, the disclosures under paragraph 27(a) for unrecognized contingent assets or liabilities would be required.
- The last sentence in Example 1 in paragraph 17 of the proposed FSP indicates that disclosures required by Statement 5 would apply to unrecognized contingent losses in a business combination under Statement 141(R). Paragraph C24 in the basis for conclusions for the proposed FSP states that the Board decided not to require any disclosures for unrecognized liabilities arising from contingencies beyond those required by Statement 5. However, the disclosure requirements for unrecognized contingencies in paragraph 27 of the proposed FSP are not identical to the requirements in Statement 5, nor do they incorporate Statement 5 requirements by reference. For example, in contrast to paragraph 27 of the proposed FSP, Statement 5 does not require for each reporting period the disclosure of changes in the range of outcomes for an unrecognized contingent gain or loss and the reasons for those changes.

We suggest that any disclosure requirements for unrecognized contingencies under Statement 141(R)

- Be provided in a separate paragraph in the FSP and in the amendments to Statement 141(R), rather than including them in a paragraph that specifies disclosures for each reporting period until the asset or liability is derecognized in full.
- Include a cross reference to Statement 5 or incorporate the disclosure requirements from Statement 5. The reference to Statement 5 disclosures in Example 1 might be missed by someone specifically searching for disclosure requirements under Statement 141(R).
- Clearly indicate

- Which, if any, disclosures required under Statement 141(R) for unrecognized contingencies are incremental to or different than the disclosures already required under Statement 5
- Whether such incremental disclosures are required until the unrecognized contingency is resolved
- Whether such incremental disclosures are required only for unrecognized contingencies from a business combination

Such a paragraph for unrecognized assets and liabilities could be drafted as follows:

The disclosures required by Statement 5 apply to an asset or liability arising from a contingency within the scope of paragraph 24 [of Statement 141(R), as amended] that is not recognized as of the acquisition date. In addition, for each reporting period until the contingency is resolved, the acquirer shall disclose any changes in the range of outcomes (undiscounted) for an unrecognized asset or liability arising from a contingency acquired or assumed in a business combination and the reasons for that change. However, an acquirer need not provide the disclosures required by this paragraph if it is not at least reasonably possible that an asset exists or a liability has been incurred. An acquirer also is not required to disclose this information for an unrecognized contingency involving an unasserted claim or assessment if a potential claimant has not indicated an awareness of a possible claim or assessment. However, disclosure is required if the acquirer determines that it is probable that a claim will be asserted and it is reasonably possible that the outcome would be unfavorable. For the purpose of applying this paragraph, the term *probable* shall have the same meaning as in Statement 5. An acquirer may aggregate disclosures for assets and liabilities arising from contingencies that are similar in nature.

Other drafting suggestions

Appendix B: Scope of the proposed amendment to paragraph 24 of Statement 141(R)

The scope exceptions in paragraph 6 of the proposed FSP should be included in the amendment to paragraph 24 of Statement 141(R). Otherwise, amended paragraph 24 will conflict with other provisions of Statement 141(R), which, for example, would allow an acquirer to choose between alternative methods of accounting for acquired contingent consideration arrangements. In addition, the requirement in paragraph 6(a) of the proposed FSP to account for the acquiree's contingent consideration arrangements assumed by the acquirer in a business combination as contingent consideration rather than as a preacquisition contingency is new guidance. It would resolve questions that have arisen on this matter and should be included in the amended text of Statement 141(R).

Appendix B: Proposed amendments to paragraph 62 and 62E of Statement 141(R)

As indicated above, the paragraph 24 amendments should include the scope exceptions from paragraph 6 of the proposed FSP, which should also be incorporated in paragraphs 62 and 62E by references to paragraph 24. Therefore, the first sentence of paragraph 62 should retain the

phrase, “in accordance with paragraph 24.” A similar reference should also be included in proposed paragraph 62E.

Appendix A: Decision tree for assets arising from contingencies

The four end state boxes under subsequent measurement and accounting should actually be shown as part of a continuous loop back to the consideration of whether new information has been obtained. In addition, this diagram might also need to be revised to address the issues raised in our response to question 2 from the Notice for Recipients.

We appreciate the opportunity to comment on the draft abstract and would be pleased to discuss our comments with the FASB staff. If you have any questions, please contact L. Charles Evans, Partner, Accounting Principles Consulting Group, at 832-476-3614 or Ann McIntosh, Senior Manager, Accounting Principles Consulting Group, at 612-677-5257.

Very truly yours,

/s/ Grant Thornton LLP