ACCOUNTING FOR ASSETS AND LIABILITIES ARISING FROM CONTINGENCIES IN A BUSINESS COMBINATION
COMMENT LETTER SUMMARY

OVERVIEW

1. The comment period on the Exposure Draft for the proposed FASB Staff Position 141(R)-a, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies, to amend FASB Statement No. 141 (revised December 2007), Business Combinations, ended on January 15, 2009.

2. As of January 23, 2009, 18 comment letters were received on the proposed FSP. Respondents expressed diverse views on several key provisions. The majority of respondents expressed general support for the proposed FSP, particularly emphasizing the need to address implementation issues in Statement 141(R). While some of those respondents expressed concerns related to specific portions of the guidance, they did not object to the overall issuance of a final FSP. However, some respondents objected to the issuance of a final FSP as proposed.

3. A profile of respondents is noted below:

<table>
<thead>
<tr>
<th>Respondent Type</th>
<th>Number of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auditors</td>
<td>6</td>
</tr>
<tr>
<td>Preparers</td>
<td>3</td>
</tr>
<tr>
<td>Users</td>
<td>1</td>
</tr>
<tr>
<td>Professional Organizations</td>
<td>5</td>
</tr>
<tr>
<td>Others</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
<td>18</td>
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Significant Issues

4. Significant issues raised by respondents that warrant consideration by the Board or that were not previously considered by the Board are as follows:

   1. Initial recognition and measurement of assets and liabilities arising from contingencies, including:

      ➢ The appropriate measurement basis to be used.
Accounting for litigation-related contingencies.

Guidance for determining whether fair value is reasonably determinable.

2. Subsequent accounting and measurement for assets and liabilities arising from contingencies, including:

- Complexity in subsequent accounting and measurement.
- Whether “new information” includes the passage of time.
- Request for additional specific guidance.

3. Disclosures, including consistency with disclosure requirements for assets and liabilities arising from contingencies outside of a business combination and concerns about prejudicial information.


5. Extending guidance to other areas in a business combination, including contingent consideration.

**Issue 1: Initial Recognition and Measurement of Assets and Liabilities Arising from Contingencies**

**Measurement Basis**

5. Several respondents had concerns that increased complexity results when (a) assets and liabilities arising from contingencies in a business combination are measured differently initially than subsequently, and (b) assets and liabilities arising from contingencies are measured in a business combination differently than how similar assets and liabilities are measured outside of a business combination. Respondents commented that the complexity arises from the requirement to track three different kinds of contingencies: (1) assets and liabilities arising from contingencies measured at fair value, (2) assets and liabilities arising from contingencies measured in accordance with FASB Statement No. 5, *Accounting for Contingencies*, and (3) assets and liabilities arising from contingencies that are initially measured at fair value and, due to new information becoming available, are subsequently accounted for in
accordance with Statement 5 and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*.

6. Respondents had a number of different views on how this complexity could be addressed. Recommendations specific to subsequent accounting and measurement are discussed in Issue 2 below. Several respondents recommended that the guidance in Statement 141 be retained without revision (United Technologies – CL #6 and KPMG LLP – CL #12) or that all assets and liabilities arising from contingencies in a business combination be accounted for in accordance with Statement 5 (Emerson – CL #13). Those respondents who recommend that the guidance in Statement 141 be retained without revision appeared to be in agreement that the Statement 141 guidance would result in the vast majority of assets and liabilities arising from contingencies being recognized in accordance with Statement 5 rather than at fair value. PricewaterhouseCoopers LLP (CL #10) indicated that the guidance in Statement 141 should be retained without revision if certain recommended clarifications are not made to the proposed FSP (refer to paragraphs 14 and 18 below for those recommendations).

7. Huron Consulting Group (CL #18) commented that it is not necessary to include guidance for accounting for assets and liabilities arising from contingencies if fair value is not reasonably determinable. They believe that if a company asserts it cannot reasonably determine the fair value of an asset or liability arising from a contingency, it is inconsistent for the company to assert that it can reasonably estimate an amount in accordance with Statement 5 and Interpretation 14. That respondent also commented that it is not appropriate to allow a company to apply Statement 5 and Interpretation 14 if fair value is not reasonably determinable because that accounting is not consistent with the revised IFRS 3. Under IFRS 3, if the fair value of a liability cannot be measured reliably, the liability is not recognized as of the acquisition date.

8. The Investors Technical Advisory Committee (ITAC) (CL #11) and Edward Trott (CL #1) had concerns that the proposed FSP will require fewer assets and liabilities arising from contingencies to be initially recognized and measured at fair value and they believe that the initial recognition and measurement guidance in Statement 141(R) should be retained or should be revised to require that all assets and liabilities arising from contingencies in a business combination be recognized at fair value,
regardless of whether they are contractual or noncontractual. These respondents indicated that the proposed FSP does not focus on the needs of users and adds complexity to an already complex standard.

9. KPMG LLP (CL #12) and McGladrey & Pullen LLP (CL #17) recommended that the Board put a project back on its agenda to address the recognition and measurement of all contingencies or participate in a project with the IASB.

Accounting for Litigation-Related Contingencies

10. Several respondents commented that the proposed FSP does not fully address concerns noted in the proposed FSP about the ability to estimate the fair value of a litigation-related contingency and an auditor’s ability to obtain a reasonable level of assurance for auditing those contingencies. Some respondents expressed concerns with the language in paragraph 13 that indicates that the ability to determine the fair value of a legal contingency depends on the stage of a case and that it is expected that sufficient information will be available to measure the acquisition date fair value of some legal contingencies in the later stages of the case. Deloitte & Touche LLP (CL #9) and McGladrey & Pullen LLP (CL #17) suggested that litigation-related contingencies be excluded from the requirement to be recognized at fair value even if fair value is reasonably determinable (that is, all litigation-related contingencies would be recognized in accordance with Statement 5). Deloitte & Touche LLP (CL #9) also recommended that environmental remediation obligations be accounted for in accordance with Statement 5. PricewaterhouseCoopers LLP (CL #10) suggested that the proposed FSP include a prejudicial exception to measuring litigation-related contingencies at fair value unless certain clarifying changes are made to the proposed FSP. Several respondents suggested that the reference to the stage of a legal case be removed or revised. The Committee on Law and Accounting of the Section of Business Law of the American Bar Association (Committee on Law and Accounting) (CL #15), which did not recommend an exception to fair value accounting for litigation-related contingencies, provided the following suggestion to revise paragraph 13 of the proposed FSP:

Because of the number of variables and assumptions involved in assessing the possible outcomes of a legal dispute, sufficient information may not exist to reasonably estimate the
date the contingency will be resolved or a range of potential resolution dates or the probabilities associated with a range of potential settlement amounts related to a legal dispute, particularly in the early stages of the case. The stage of the legal dispute, as well as the nature of the legal dispute, including experience with similar legal disputes in the past, are among the factors that will affect an entity’s ability to value a legal dispute. Therefore, entities often will not be able to reasonably determine the acquisition-date fair value of a liability arising from a legal contingency, particularly in its early stages. However, it is expected that sufficient information will be available to measure the acquisition-date fair value of other assets and liabilities arising from contingencies other than legal disputes in a business combination, including some legal contingencies in the later stages of the case.

11. Huron Consulting Group (CL #18) commented that paragraph 13 was not necessary because the determination of whether the fair value of an asset or liability arising from a contingency is determinable is a matter of facts and circumstances.

Guidance for Determining Whether Fair Value is Reasonably Determinable

12. The majority of respondents indicated that the guidance in paragraph 10-13 of the proposed FSP for assessing whether fair value can be reasonably determined is useful. Several respondents indicated that additional guidance or clarification for assessing whether fair value can be reasonably determined is necessary. Deloitte & Touche LLP (CL #9) commented that the mere identification of a range of potential future resolution dates and cash flows and the associated probabilities of occurrence for each should not be a determinative factor in assessing whether fair value is reasonably determinable, rather the reasonableness of the range should also be considered (for example a very large range may be an indication that the fair value of a contingency is not reasonably determinable).

13. PricewaterhouseCoopers LLP (CL #10) suggested that clarifying language be included in the proposed FSP to indicate that methods of estimating fair value other than those described in the proposed FSP may be appropriate. United Technologies (CL #6) requested more examples that demonstrate how to determine the fair value of contingencies related to pending or anticipated claims and litigation. Huron Consulting Group (CL #18) expressed concerns that the proposed FSP does not
address questions regarding how the fair value of a liability should be determined, such as whether legal fees should be included in the fair value of the liability.

14. Huron Consulting Group (CL #18) also commented on differences between the guidance in paragraphs 10–13 of the proposed FSP and FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations*. This respondent questioned why the “method of settlement or potential methods of settlement” was not included in the information that must be available to reasonably determine fair value in the proposed FSP and questioned the use of the term “reasonably determined” instead of the term “reasonably estimated,” which was used in Interpretation 47. Several other respondents (Deloitte & Touche LLP - CL #9, Credit Suisse Group– CL #16, and McGladrey & Pullen LLP - CL #17) also requested that the Board clarify the difference, if any, between the terms “reasonably determinable” and “reasonably estimable.”

**Issue 2: Subsequent Accounting and Measurement**

**Complexity in Subsequent Accounting and Measurement**

15. As noted in Issue 1, several respondents had concerns that the differences in initial and subsequent measurement of assets and liabilities arising from contingencies in a business combination increases complexity. Ernst & Young (CL #4) recommended that assets and liabilities arising from contingencies in a business combination be subsequently measured on the same basis as they are originally measured (that is, assets and liabilities initially recognized at fair value should continue to be re-measured at fair value in subsequent periods and assets and liabilities originally recognized in accordance with Statement 5 should continue to be measured under that standard). Although Edward Trott (CL #1) and ITAC (CL #11) disagreed with the initial recognition guidance in the proposed FSP that would allow for assets and liabilities arising from contingencies to be recognized in accordance with Statement 5 if fair value is not reasonably determinable, these respondents indicated that assets and liabilities initially recognized at fair value should be subsequently remeasured at fair value. PricewaterhouseCoopers LLP (CL #10), Deloitte & Touche LLP (CL #9), and Emerson (CL #13) indicated that they did not believe that the proposed FSP should be changed to require remeasurement of contingent assets and liabilities at fair value.
value each reporting period. PricewaterhouseCoopers (CL #10) commented that the difference in initial and subsequent measurement is consistent with the overall accounting guidance for business combinations in which assets and liabilities are measured at fair value on the acquisition date and subsequently accounted for on a different basis in accordance with other GAAP.

16. Huron Consulting Group (CL #18) had concerns about complexity as well as the fact that that the proposed FSP would not allow for a liability arising from a contingency that is recognized at fair value to be reduced as a result of changes in facts and circumstances subsequent to the acquisition. This respondent recommended that the subsequent accounting guidance for liabilities arising from contingencies be simplified by requiring the same subsequent accounting regardless of whether the liability was initially measured at fair value or in accordance with Statement 5. Under this approach, regardless of whether the liability was initially measured at fair value or in accordance with Statement 5, if the acquirer is released from risk or fulfills its performance obligation over time, the acquirer would reduce the liability as it is released from risk or fulfills its performance obligation. All other liabilities would subsequently be accounted for in accordance with Statement 5. However, adjustments would only be permitted when new information about the contingency is obtained. This respondent believes that this method would alleviate concerns about an entity recognizing a Day 2 gain or loss when switching from a fair value to a Statement 5 measurement, while allowing for a reduction in the liability when new information is obtained that indicates the liability is less than the acquisition-date fair value.

17. PricewaterhouseCoopers LLP (CL #10) also recommended that the FSP clarify that an entity can be released from risk as a result of the passage of time.

New Information

18. KPMG LLP (CL #12) had concerns that the requirement for evaluating whether an acquirer has obtained “new information” introduces significant complexity into the accounting for assets and liabilities arising from contingencies, particularly in cases where it is initially remote that the obligation will be enforced and new information about the contingency is not expected to be obtained. PricewaterhouseCoopers LLP
(CL #10) and McGladrey & Pullen LLP (CL #17) suggested that the proposed FSP clarify whether “new information” includes the passage of time (that is, whether a liability can be derecognized when the passage of time supports a conclusion that the obligation will not be enforced).

**Request for Additional Specific Guidance**

19. PricewaterhouseCoopers LLP (CL #10) and Huron Consulting Group (CL #18) recommended that the Board include additional guidance or examples regarding how the subsequent accounting guidance in the proposed FSP should be applied to a liability arising from a contingency when the fair value of the liability includes multiple cash flows streams (for example, legal fees, consultation fees, and environmental clean-up costs).

20. Deloitte and Touche LLP (CL #9), PricewaterhouseCoopers LLP (CL #10), and Huron Consulting Group (CL #18) requested that guidance be provided for liabilities in which the only difference between fair value and that amount that would be recorded under Statement 5 is due to discounting (that is, whether accretion of the acquisition-date fair value is permitted (or required) or whether the liability may only be increased when new information is obtained).

**Issue 3: Disclosure**

21. A number of respondents had concerns about the differences between the disclosure requirements for assets and liabilities arising from contingencies in a business combination and for assets and liabilities arising from contingencies outside of a business combination. In particular, these respondents were concerned with the requirement to disclose a range of expected outcomes and changes in those ranges without a provision allowing an entity to omit these disclosures if the range is not reasonably estimable and the requirement to disclose the amount recognized without an exception to disclosing that information if it is prejudicial. The Committee on Law and Accounting (CL #15) also had concerns about the requirement to disclose the reasons why the fair value of a liability cannot be reasonably determined. The majority of those respondents recommended that the FSP simply refer to the disclosures required by Statement 5 until the Board completes its project to reconsider the disclosure requirements for all contingencies.
22. PricewaterhouseCoopers LP (CL #10) recommended that if the disclosure requirements in the proposed FSP were not replaced with the requirements in Statement 5, the FSP include a prejudicial exception for instances in which the required disclosures would be prejudicial. Ernst & Young (CL #4) and the Committee on Law and Accounting (CL #15) recommended that the disclosures in the proposed FSP only apply to assets and liabilities arising from contingencies that are initially measured at fair value. Those respondents recommended that the disclosure requirements in Statement 5 apply to all other assets and liabilities arising from contingencies, including unrecognized assets and liabilities.

23. Credit Suisse Group (CL #16) agreed with the revised disclosure requirements in the proposed FSP and indicated that “not having to disclose unrecognized contingencies provides sufficient relief for reporting entities and still provides users of financial statements with relevant information.” ITAC (CL #11) and Edward Trott (CL #1) opposed any changes to the disclosure requirements in Statement 141(R). ITAC recommend that the Board abandon this proposed FSP and focus its efforts on developing a new standard to address flaws in Statement 5.

**Issue 4: Contingent Consideration of an Acquiree**

24. Several respondents commented on paragraph 6(b) of the proposed FSP, which states that contingent consideration arrangements include an acquiree’s contingent consideration agreement assumed by the acquirer in a business combination. Ernst & Young (CL #4) and Huron Consulting Group (CL #18) commented that an acquiree’s contingent consideration arrangement does not meet the definition of contingent consideration in paragraph 3 of Statement 141(R) because it is not an obligation to the parties that sold the business to the acquirer. PricewaterhouseCoopers LLP (CL #9) commented that such arrangements have historically been accounted for as preacquisition contingencies in practice and Deloitte & Touche LLP (CL #10) had concerns that the proposed guidance may conflict with IFRS 3. Grant Thornton LLP (CL #14) commented that this requirement represents new guidance that would resolve questions that have arisen on this matter. These respondents recommended that the Board reconsider whether contingent consideration arrangements of an acquiree should be considered contingent consideration. If the Board considers an acquiree’s contingent consideration arrangement to be contingent consideration and
not a pre-acquisition contingency, these respondents believe that the definition of contingent consideration should be revised in Statement 141(R) and the reason for the change should be included in the Basis for Conclusions.

**Issue 5: Extending Guidance to Other Areas in a Business Combination**

25. The Private Company Financial Reporting Committee (CL#5) recommended that the Board consider whether applying the approach in the proposed FSP to other areas in a business combination, such as accounting for contingent consideration, would improve financial reporting.