MINUTES

Financial Accounting Standards Board

To:	Board Members
From:	Cizek (ext. 345)
Subject:	Minutes of the September 6, 2007 Board Meeting—Accounting for Contingencies
Date:	September 18, 2007
cc:	FASB: Bielstein, Golden, MacDonald, Cosper, Roberge, Hood, Elsbree, Cizek, Tamulis, Vessels, Posta, Bossio, Delmonico, Choi, Chookaszian, Polley, Lott, Gabriele, Allen, Klimek, Intranet; IASB: Leisenring

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement, Interpretation, or FASB Staff Position.

Topics:	FASB Statement No. 5, *Accounting for Contingencies*
Basis for Discussion:	Board Memorandum Dated August 8, 2007
Length of Discussion:	9:30–10:30 a.m.

Attendance:

Board members present:	Herz, Batavick, Crooch, Linsmeier (via phone), Seidman, Young, and Smith
Board members absent:	None
Other Participants:	None
Staff in charge of topic:	Roberge
Other staff at Board table:	Golden, Cosper, Tamulis, and Cizek

Summary of Decisions Reached

The Board added a project to its technical agenda to comprehensively reconsider the accounting for contingencies, as currently provided for in FASB Statement No. 5, *Accounting for Contingencies.* As a first step, the Board will consider enhancing the disclosure requirements about contingencies to address constituents' concerns that information about contingencies may not currently be disclosed in the notes to the financial statements on a timely basis. At the same time, the Board instructed the staff to begin preliminary research to consider the scope, timing, and identification of potential convergence issues relating to a comprehensive, long-term project for the accounting for contingencies.

The Board also decided to change its previous decision that assets and liabilities arising from contingencies that are recognized in a business combination should subsequently be measured at fair value. Instead of fair value, the Board decided that those assets and liabilities should be measured as follows:

A liability will be measured at the higher of either:

a. Its acquisition-date fair value; or
b. The amount that would be recognized by applying Statement 5.

An asset will be measured at the lower of either:

a. Its acquisition-date fair value; or
b. The best estimate of its future settlement amount.

The Board directed the staff to prepare a revised draft of proposed FASB Statement No. 141 (revised), *Business Combinations,* for vote by written ballot.

Objectives of Meeting:

The objective of the meeting was to determine if the Board wished to add a project to its technical agenda addressing the accounting for contingencies. Two alternative approaches were recommended by the staff if the Board decided to add a project on this topic. The first alternative proposed a short-term project addressing the recognition, measurement, and disclosure for a narrow scope of contingencies. The goal of this alternative would align guidance between Statement 5 and proposed Statement 141(R). The second alternative would add a phased project to address the accounting for contingencies comprehensively. Phase 1 would attempt to eliminate inconsistencies in measurements required by Statement 5 and proposed Statement 141(R) when accounting for contingencies after the initial date of recognition under proposed Statement 141(R). Phase 2 would develop enhanced disclosure requirements for contingencies as defined in Statement 5. Phase 3 would comprise a comprehensive project to comprehensively reconsider all accounting models for contingencies.

Matters Discussed and Decisions Reached

1. Mr. Roberge opened the discussion by explaining that the purpose of the meeting was for the Board to consider whether to add to its technical agenda a project revising the guidance on accounting for contingencies as currently provided for in Statement 5, including gain contingencies. Since Statement 5 affects many areas of accounting today, users of financial statements expressed concerns that as a result of Statement 5's recognition criteria, delayed recognition of assets and liabilities occurs in practice. Also, users consider the disclosure criteria in Statement 5 to be inadequate or ineffective, as application in practice seems limited. Consequently, the Board contemplated adding a project to reconsider the accounting for contingencies.

2. Mr. Roberge also stated that the Board deviated from Statement 5's recognition and measurement criteria in certain standards and implementation issues, including FASB Statement No. 143, *Accounting for Asset Retirement Obligations,* FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities,* FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes,* and most recently within proposed Statement 141(R). In those cases, the Board decided that recognition and measurement under the new guidance is more appropriate than the Statement 5 approach. For example, in proposed Statement 141(R), contractual contingencies acquired in a business combination would be measured at fair value. Noncontractual contingencies would be recognized and

measured at fair value if it is more likely than not that those contingencies meet the definition of elements in FASB Concept Statement No. 6, *Elements of Financial Statements.* The staff was informed that certain key constituents oppose the difference in measurement guidance between Statement 5 and proposed Statement 141(R). The IASB is reconsidering its standard on contingencies in a project that commenced in 2002. Mr. Roberge asked the Board if it would like to add a project on contingencies to the technical agenda. If so, the staff would present two alternative approaches for the Board's consideration.

3. Mr. Herz asked the other Board members if their vote to add a project to the agenda depended on the alternatives proposed. Mr. Linsmeier said that his decision would depend on the alternatives. Ms. Seidman stated that it seems like Phase 1 of Alternative B (see attached audience handout) would not require a new project but could be addressed within the context of the business combinations project. Mr. Smith responded that this would depend on whether or not the Board takes on Phase 1 before the issuance of Statement 141(R). Mr. Herz concluded that it would be most effective to discuss each alternative prior to voting on an overall project.

4. Mr. Roberge stated that under Alternative A, the Board could add a short-term project to its agenda addressing a narrow scope of contingencies that would reconsider recognition, measurement, and disclosure of contingencies. Part of the scope would include aligning the guidance for contingencies in proposed Statement 141(R). Under this alternative, the staff would not seek convergence opportunities with the current project because the IASB has to reconsider and potentially amend IAS 37, *Provisions, Contingent Liabilities and Contingent Assets.* Mr. Golden added that this alternative does not imply that the Board would amend Statement 5 to reflect the Board's conclusions from proposed Statement 141(R). Instead, the Board would reconsider guidance within Statement 5 for loss contingencies and gain contingencies independently from proposed Statement 141(R), and, at the end of Phase 1, determine if a change would be required in the standard on business combinations. Mr. Batavick stated

that it may be challenging to accomplish the goals of Alternative A in the short term as proposed.

5. Mr. Golden responded that by narrowly scoping the project to include only loss and gain contingencies, it may be possible to reconsider recognition and measurement of those items alone. Impairments, Statements 143 and 146, Interpretation 48, and other items that fall under Statement 5's guidance would not be affected by this alternative. Mr. Batavick clarified that the newly developed guidance would amend Statement 5 for the stated contingencies and also be considered for proposed Statement 141(R). Mr. Golden stated that if at the end of the project the measurement was not fair value, the staff would ask the Board if it would like to reconsider the measurement attribute for contingencies assumed in a business combination. Mr. Smith stated that the goal of alignment refers to eliminating differences between contingencies acquired through a business combination and those that arise in the normal operations of a business. Mr. Batavick observed that this goal would run the risk of not being convergent with the IASB's guidance on contingencies.

6. Mr. Linsmeier stated that the Board should be aware that in voting for Alternative A, the Board may be taking on a project that could take several years as has occurred with the IASB's project on IAS 37. Mr. Golden responded that the Board would not reconsider the occurrence event (also referred to as the obligating event) or detection risk. The focus would be solely on the recognition threshold and measurement attribute for loss and gain contingencies. If the Board decided to address the occurrence event, the timing could be affected. Ms. Seidman also clarified that losses on receivables and other guidance that cross-references Statement 5, such as FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises,* and FASB Statement No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts,* would not be included in the narrow scope.

7. Mr. Roberge added that Alternative A would not reconsider the guidance for contingent consideration. The accounting for contingent consideration would continue to be fair value at the acquisition date and for subsequent measurements.

Mr. Herz asked if the staff was recommending to reconsider the differences in initial measurement for contractual and noncontractual contingencies in Phase 1 of Alternative B. Mr. Roberge responded that the staff was only recommending changes to guidance for subsequent measurement, not the initial measurement as prescribed in proposed Statement 141(R).

8. Mr. Roberge stated that Alternative B would include three phases. Phase 1 would be a short-term project to eliminate inconsistencies for subsequent measurement of contingencies between Statement 5 and proposed Statement 141(R) by requiring contingencies to subsequently be measured at the higher of the Statement 5 amount and the acquisition-date fair value for contingent liabilities. For contingent assets, the subsequent measurement would be the lower of the acquisition-date fair value and the best estimate of a future settlement amount. In Phase 2, the Board would consider developing enhanced disclosure requirements for contingencies as currently defined in Statement 5. The recommendation for Phase 2 is a result of feedback received from investors and users that financial statements prepared by entities seem to lack timely and adequate disclosures of contingencies. Phase 3 would then comprehensively reconsider all the accounting for contingencies. A proposed scope, timing, and the identification of potential convergence opportunities with the IASB would be explored by the staff and presented to the Board at a future date.

9. Mr. Herz replied that future research would be needed to determine which standards would be affected by Phase 3. The Board would need to understand which key attributes make up a homogenous population of contingencies to address. Mr. Smith added that he does not understand the scope of Phase 3, such as why Statement 143 would be included but asset impairments would not. Mr. Roberge stated that the Board would need to determine a scope for the project at a later date. Mr. Linsmeier added that the scope would probably include all of Statement 5 and may include other guidance. Additionally, Phase 3 would address when the obligation is incurred. That would be separate from Alternative A, which would not address when the obligation is incurred. For Mr. Linsmeier, addressing the uncertainty surrounding the likelihood of occurrence, not just a

recognition threshold and measurement attribute, is key for Phase 3. Mr. Herz stated that Phase 3 would also have a convergence goal.

10. Ms. Tamulis stated that a key component of Phase 3 seems to be the opportunity to reexamine all guidance related to Statement 5 in which deviation or inconsistency applies, including Statements 143 and 146 and loan losses. Alternative A would not give the Board that opportunity. Mr. Herz agreed and offered as an example, but not as a proposal, that the Board could maintain the guidance in Statement 5 but then choose to apply it to other guidance that currently is inconsistent. Ms. Seidman added that she feels guidance on loan losses is in need of reconsideration by the Board. As the guidance relies in part on Statement 5, that could be included in Phase 3. However, one concern she has with convergence relates to the IASB's decision to scope loan losses out of its current project on contingencies.

11. Mr. Linsmeier stated that his initial concern with Alternative A is that the Board would be missing an opportunity to reconsider Statement 5 comprehensively. He previously suggested Alternative B to the staff, as it would allow the Board to complete a project without pressure due to timing. Choosing Alternative B would mean reversing his previous vote for contingencies assumed in a business combination, but he would change his vote if it meant ultimately achieving an improved standard on contingencies.

Board Views

12. Ms. Seidman stated that she previously voted against the subsequent measurement for contingencies in the business combination project because of the inconsistencies that would result for essentially the same items that arose from different circumstances. Also, at that time she expressed support for a comprehensive reconsideration project for Statement 5. Therefore, she would support Alternative B and the three phases included in the staff's recommendation. For Phase 1, she believes that the change would not entirely eliminate differences between Statement 5 and proposed Statement 141(R), but that the recommended change would minimize inconsistency. Also, she would

support the recommendation to address the disclosure requirements within Statement 5 in the near term. Finally, she would support a reconsideration of Statement 5 with an open mind to the scope, recognition, and measurement conclusions. Her concern with Alternative A is that this recommendation would create yet another model for a narrow scope of contingencies, further increasing complexity in accounting.

13. Mr. Young stated that he believes nothing presented by the staff constitutes a new issue that would require the Board's reconsideration. Overall, the issues raised seem more about implementation and cost-benefit concerns than about the problems with the guidance within the standard itself. Specifically, other areas of accounting also have inconsistencies; this change seems no more significant. Also, Mr. Young stated that he is not convinced that contingencies arising from a business combination should be the type to drive a complete reconsideration of Statement 5. Therefore, Mr. Young would vote not to add the project to the Board's agenda. Instead, he would recommend that the staff conduct fieldwork relating to the implementation of Statement 141(R) surrounding the guidance for contingencies.

14. Mr. Batavick stated that he would support Alternative B with the caveat that Phases 2 and 3 begin at a much later date, after 6–9 months of staff research prior to readdressing the Board. The change proposed in Phase 1 would eliminate some of the operational issues with subsequently remeasuring the fair value of contingencies at the time of financial statement preparation. Also, his understanding is that Phase 1 would be independent of Phases 2 and 3. Mr. Golden stated that the staff's proposal was to begin phase 2 as an interim step to phase 3. Mr. Linsmeier stated that he believes Phase 2 would rely on Phase 1 so that users could understand ranges associated with the acquired contingency after the initial measurement date. Otherwise, users could be misled about the value of the contingency if, for example, in the case of a contingent loss, the fair value decreased but the initial measurement would remain on the financial statements per the proposed amendment. Mr. Smith stated that he believes the lack of disclosure in practice today results from compliance issues, not problems within

Statement 5's guidance. He also stated that his understanding of Phase 1 would incorporate disclosures that explain to users the meaning of the disclosed number.

15. Ms. Tamulis stated that proposed Statement 141(R) would already require that preparers disclose changes in fair value, changes in inputs, and changes in the estimated range occurring subsequently. It may be possible for the staff to slightly alter the language, including the range disclosure to address the problem raised by Mr. Linsmeier. Ms. Seidman and Messrs. Smith and Batavick all agreed with that suggestion. Ms. Seidman also stated that the staff may be able to leverage the work done in Phase 1 for possible changes to be made in Phase 2. Mr. Roberge replied that the intent of the recommendation was to complete Phase 2 in the short term and apply it to Statement 5, not just contingencies arising from a business combination.

16. Mr. Roberge suggested that words could be changed in Statement 5 that would force better disclosure from the preparer community. Mr. Herz stated that some may believe that if measurement is not forced, disclosure also may not be possible. Mr. Golden replied that Statement 5's disclosure requirements include qualitative information and situations in which there is at least a reasonable possibility that a loss may have been incurred. Mr. Roberge added that roll-forward disclosure could provide better information to financial statement users.

17. Mr. Linsmeier stated that there are two problems existing within the current standard that may be preventing disclosure—element uncertainty and measurement uncertainty. The Board may be able to add rigor to the wording in the Statement 5 that would not allow these "outs" for preparers. Mr. Golden asked if Mr. Linsmeier was suggesting a different measurement attribute for disclosures instead of recognition. Mr. Linsmeier responded that he was suggesting the Board reconsider the "reliably measurable" wording as the threshold for disclosing a range. There may be a way to write the standard that would allow less room for preparers to omit disclosure other than to assert that no reasonable estimate can be made.

18. Mr. Crooch stated that he feels conflicted by the staff's recommendation. For a long time he has considered Statement 5 to be a standard that has not worked very well and that has resulted in significant noncompliance. He believes the Board should reconsider the accounting for contingencies comprehensively. However, he thinks the Board came to the right answer regarding accounting for contingencies in the business combination project. Therefore, he is conflicted because Alternative B seems to suggest that proposed Statement 141(R) does not have the right answer. Mr. Crooch stated that he would not vote for Phase 1 of Alternative B, but that he would support Phases 2 and 3.

19. Mr. Smith stated that he was not a Board member during the deliberations for proposed Statement 141(R). As Phase 1 is a change to the guidance in proposed Statement 141(R), he plans to abstain from voting on this issue. Mr. Smith would support Phase 3 with a scope to be determined at a future date based on further staff research. In relation to Phase 2, Mr. Smith stated that he believes Phase 2 would not be successful, especially considering that disclosure projects in the past have been frustrating in part due to the lack of guidance in the conceptual framework for disclosure. The current problems with Statement 5 seem to be due to compliance as well. Mr. Young asked Mr. Smith if he believes contingencies arising from a business combination were a good place to begin a contingency project. Mr. Smith stated that he agreed with Mr. Young that contingencies arising from a business combination should not be the basis for a Statement 5 reconsideration. Mr. Linsmeier added that the reason he proposed Alternative B was to separate a Statement 5 reconsideration from the accounting for contingencies resulting from the business combination project. He hoped the project may take two to three years and possibly leverage the work of the IASB. Mr. Smith replied that he believes part of the original business combination solution led to convergence.

20. Ms. Tamulis stated that IAS 37, as currently written, was more like fair value. The two standards would be converged in that day one accounting would be fair value and day two accounting would be each Boards' respective standard for

contingencies. The model for contingencies is therefore the same, but the resulting measurement attributes in each situation would be different.

21. Mr. Herz stated that he also agrees that Statement 5 needs enhancement. Therefore, he would support adding a comprehensive project to the Board's agenda with a scope to be determined. Mr. Herz stated that he believes the accounting for contingencies in proposed Statement 141(R) should remain as required in FASB Statement No. 141, *Business Combinations.* One key concern in the new guidance is the difference at the time of initial measurement between contractual and noncontractual contingencies. Mr. Herz stated that he believes this may lead to implementation problems in determining whether a contingency would be contractual or noncontractual. However, as this had little support from other Board members, he would instead vote for Alternative B as written by the staff. For Phase 1, Mr. Herz stated that he believes the Board should reballot proposed Statement 141(R) to amend the corresponding paragraph and change the basis for conclusions. He also stated that he supports Phase 2 as written to amend disclosure requirement in the interim related to the "reasonably possible" language. As this aspect of the proposed Statement 141(R) was not converged, voting for Alternative B would not conflict with Mr. Herz's overall support for a converged standard.

Board Vote:

22. The Board voted to re-ballot Statement 141(R). Four board members supported this change, including Mr. Herz, Ms. Seidman, Mr. Linsmeier and Mr. Batavick. Mr. Smith abstained from voting on this issue.

23. The Board also voted to add Phases 2 and 3 of Alternative B to its technical agenda. Board members in support of this change included Mr. Herz, Ms. Seidman, Mr. Linsmeier, Mr. Batavick, Mr. Smith and Mr. Young. Mr. Herz stated that most members in support of Phase 3 also wanted the phase to consider convergence as a possible goal.

Follow-up Items:

None

General Announcements:

None