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LETTER OF COMMENT NO.

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Technical Director - File Reference: Proposed FSP FAS 141(R)-a
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

PricewaterhouseCoopers LLP appreciates the opportunity to provide comments on the proposed FASB Staff Position (FSP) FAS 141(R)-a, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise From Contingencies* (the "proposal" or the "FSP"). We support the Board's objective to improve the application of Statement 141(R) related to the initial recognition and measurement, subsequent measurement and accounting, and disclosures of assets acquired and liabilities assumed arising from contingencies in a business combination.

The changes proposed in the FSP would be improvements to the current provisions of Statement 141(R). We generally support the recognition of acquired contingent assets and assumed contingent liabilities at fair value when fair value is reasonably determinable. However, the practice of measuring nonfinancial liabilities at fair value is still evolving. We believe the practice of recording liabilities at fair value needs to develop more before an expectation should exist that fair value can be reasonably determined for a contingent liability. Until then, we believe companies may find it difficult to reasonably determine the fair value of assumed contingent liabilities.

We also understand that it is the Board's intent that contingent liabilities related to litigation would typically not be recorded at fair value in acquisition accounting unless settlement with little risk of material variability is imminent. However, we are concerned that the proposed FSP, as written, may be interpreted by some as establishing an expectation that litigation related contingencies in later stages should be recorded at fair value. Due to the nature, complexity and unpredictability of litigation, we do not believe contingencies related to most litigations, regardless of stage, would meet the proposed FSP's requirements to be recorded at fair value. Therefore, to avoid uncertainty in practice, we recommend the reference to the stages of litigation in the FSP be deleted.

In light of the FASB's re-deliberation of its project to amend disclosures of certain loss contingencies, it seems premature to require new disclosures in this FSP until those re-deliberations are complete. Therefore, we recommend that the FASB revise this FSP to require companies to follow the disclosure requirements in Statement 5 or "other GAAP" for contingencies acquired in a business combination until the Board's re-deliberations are complete.

If the FASB nevertheless issues the FSP as proposed, we are concerned that certain contingencies recorded at fair value and the related proposed disclosures could be prejudicial to a company. Therefore, we recommend that the FASB consider adding a prejudicial exemption to the recognition, measurement, and disclosure provisions of the proposed FSP.

We recommend that certain revisions be made to the proposed FSP to address these concerns, and we describe those revisions in our responses to the questions set out in the exposure draft. Our responses to the specific questions contained in the Notice for Recipients, together with additional comments on the proposed guidance, are attached in Appendix A to this letter. Additionally, in Appendix B, we recommend certain clarifications and editorial changes.

If you have any questions regarding our comments, please contact Michael J. Gallagher at (973) 236-4328, Lawrence N. Dodyk at (973) 236-7213, or John R. Formica, Jr. at (973) 236-4152.

Sincerely,

A handwritten signature in black ink, appearing to read "PricewaterhouseCoopers LLP". The signature is written in a cursive, flowing style.

PricewaterhouseCoopers LLP

**Appendix A - Response to Questions:
Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise
From Contingencies – an amendment of FASB Statement No.141(R)**

- 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?**

Subject to the clarifications we recommend in our response to the questions set out in the exposure draft, we believe the amendments to Statement 141(R) in the proposed FSP will address certain of the application issues that have arisen in this area with Statement 141(R). The proposed changes will eliminate many of the concerns we expressed in our comments to the FASB during its deliberations of Statement 141(R) and the proposed amendments to disclosures of certain loss contingencies, as well as the concerns about the accounting for acquired contingencies under Statement 141(R) expressed in the letter issued by the Center for Audit Quality on October 28, 2008, which we endorsed. Therefore, we do not believe the current requirements in Statement 141(R) should be retained.

Paragraph 6.b. of the proposed FSP indicates that an acquiree's contingent consideration arrangements assumed by the acquirer in a business combination should be accounted for as contingent consideration in accordance with paragraphs 41, 42, and 65 of Statement 141(R). We believe that under current practice an acquirer recognizes an acquiree's contingent consideration arrangements assumed by the acquirer in a business combination as a contingent liability similar to other contingencies of the acquiree (e.g., R&D milestone or royalty payment obligations) rather than as contingent consideration since payment is not being made to the selling shareholders of the acquiree. If a change in practice is intended, the Board should consider providing comments in the basis for conclusions as to why the Board believes an assumed obligation of the acquiree meets the definition of contingent consideration under Statement 141(R).

- 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. 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)?**

Subject to the clarifications we recommend in our response to the questions set out in the exposure draft, we support the Board's decision to provide additional guidance on determining whether the fair value of an asset or liability arising from a contingency can be reasonably determined as well as providing additional guidance on the subsequent measurement of acquired contingencies. Absent these clarifications, we believe the Board should carry forward the requirements in Statement 141 without reconsideration as many of the same issues inherent in the Board's project on disclosures of certain loss contingencies will exist under this proposed FSP.

We do not 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. This is generally consistent with the overall accounting guidance for a business combination in which certain assets acquired and liabilities assumed are recognized and measured at fair value on the acquisition date and accounted for on a different basis in accordance with other GAAP in subsequent periods.

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?

We generally believe the costs of implementing the proposed FSP would be less than the costs of implementing the original provisions for acquired contingencies in Statement 141(R). However, recording litigation-related contingencies¹ at fair value could result in unintended costs and consequences. As written, we believe that these costs and consequences of implementing the proposed FSP will be substantial and will carry all of the same concerns, issues, and impediments as expressed to the Board in connection with its project on disclosures of certain loss contingencies.

We are particularly concerned with the recognition and disclosure requirements of the FSP for litigation-related contingencies if the contingencies were to be recorded at fair value. As we expressed in our comment letter on the FASB's project on disclosure of certain loss contingencies, measuring a litigation-related contingent liability at fair value will entail substantial consultation with the company's legal counsel so that management and the company's auditor understand the probability of various outcomes, as well as understand several other critical issues. Providing such information to the company's auditors could jeopardize the attorney-client privilege, attorney work-product doctrine, and other legal protections. However, by withholding such information, management runs a risk that the company's auditors would be unable to opine on financial statements containing litigation related contingencies recorded at fair value and the related disclosures.

Further, for litigation-related contingencies, the fair value amount recorded and the related disclosures could be used against the company, either in the courtroom or in settlement negotiations. As a result, the amount recorded by a company for a litigation-related contingency could turn into a self-fulfilling prophecy. Therefore, we believe that most litigation-related contingencies should not be recorded at fair value, even later stage cases. If the FASB does not revise the current requirements in the proposed FSP, we recommend that a prejudicial exemption be provided, whereby companies would not be required to record litigation-related contingencies at fair value, even those in later stages, if companies can support their assertion that recording such an amount would be prejudicial to their particular case.

4. This proposed FSP includes guidance for assessing when the fair value of an asset or liability arising from a contingency in a business combination can be reasonably determined. 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.

The guidance in paragraphs 10–13 of the proposed FSP provides useful guidance for assessing whether fair value can be reasonably determined. However, we recommend the following points of clarification and suggested edits:

¹ Our comments related to litigation related contingencies are intended to also apply to other equivalent disputes or potentially adversarial circumstances, such as governmental examinations, regulatory reviews, arbitrations, or similar situations involving negotiations between the parties. We believe the FSP should also be clarified in this respect to ensure that references to litigation are not understood to be more narrow in scope than intended.

- We believe it is the Board's intent that contingent liabilities related to litigation would typically not be recorded at fair value in acquisition accounting unless settlement with little risk of material variability is imminent. Due to the nature, complexity and unpredictability of litigation, we do not believe contingencies related to most litigations, regardless of stage, would meet the proposed FSP's requirements to be recorded at fair value. As a result, we recommend that paragraph 13 be amended to remove the phrases "particularly in the early stages of the case" in the first and second sentences and "including some legal contingencies in the later stages of the case" in the third sentence.
 - When measuring the warranty liability at fair value, example 2 in paragraph 17 utilizes "the potential undiscounted amount of all future payments" to identify the range of the liability and therefore could lead a reader to believe that the acquirer's undiscounted cost of performance would be the basis for the fair value measurement of the liability. We believe some companies might instead use an exit price based on the cost a company would have to pay to a market participant to assume the liability (including a profit element, since a market participant would likely want to be rewarded for its efforts). Similar to the determination of fair value for other assets and liabilities, we believe that there may be more than one reasonable method to determine the fair value of the warranty liability. We suggest clarifying the example to indicate that the method used to determine the fair value of the warranty liability is one acceptable approach.
 - Some of the language in the proposed FSP, particularly in paragraph 10, focuses on the use of an income approach to measure fair value, incorporating the timing and amount of future cash flows. This language suggests that a discounted cash flow analysis should be used to determine the fair value of a contingent asset or liability. However, the resolution of contingencies often involves numerous outcomes and decision points. The probability of future payments is a function of these outcomes and decisions. A simple discounted cash flow method cannot capture this reality and therefore is not an accurate measure of exposures that have asymmetrical distributions (typical for many contingencies) or path dependencies. In our experience, methods that consider a distribution of possible future outcomes, such as a probability weighted expected return method ("PWERM"), option model, lattice model, or Monte Carlo simulation, are more effective to measure these risks. While the FASB does refer to an income approach, which could include other valuation models, we suggest that the final FSP acknowledge that the valuation methodology should consider whether a distribution of outcomes or path dependency is important in the valuation. We also suggest that the final FSP clarify that a PWERM, option model, lattice model, Monte Carlo simulation, or other similar models are methods that could also be used to value contingent assets and liabilities.
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 believe the proposed amendment to Statement 141(R) should clarify whether "new information" includes the passage of time. For example, a company may record a contingency at fair value on the acquisition date with a remote likelihood that it will be enforced. There may be no new information obtained for a number of years, if ever, related to that contingency. That is, the contingency is effectively "resolved" with the passage of time, resulting in no payments being made by the company. In that case, if there is no new information other than the passage of time, we believe derecognition should occur and the liability would be reduced based on the specific facts and circumstances related to the contingency.

With regard to subsequent measurement, we have requested clarification, which is detailed in our response to Question No. 6 below.

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, we believe the clarifying guidance included in the proposed FSP is generally operational for the subsequent measurement and accounting of a liability initially recognized at fair value. However, we offer the following comments to improve its operability.

- Paragraph 19 of the proposed FSP indicates that if the acquirer is released from risk or fulfills its performance obligation over time, the liability shall be reduced as that risk is released or performance occurs. The term "released from risk" should be revised to clearly articulate that the recorded amount of an acquired contingency can also be reduced as a result of the passage of time. For example, a company may reduce its recorded liability for a guarantee as time passes and the guarantee's expiration date becomes closer, reflecting the fact that the company has adhered to its commitment to "stand ready" even though it has not yet had to perform under the obligation. More specifically, an action may not be needed (e.g., a legal release by the counterparty) for the liability to be reduced.
 - We believe many acquired contingencies will involve multiple elements that may factor into the determination of fair value. For example, in determining the fair value of a contingent liability, companies will include expected third party costs, such as legal and consultation fees, that they expect to incur to remediate or resolve the contingent liability. We recommend that the Board provide an example of the subsequent accounting for the contingent liability as such costs are incurred.
 - The proposed FSP could result in a company recognizing a liability at fair value, the amount of which could be less than the ultimate settlement amount that may be expected to be paid solely due to discounting. It would be useful for the FSP to address how an acquirer would transition from fair value to a Statement 5 measurement in such an instance (e.g., accrete over time, immediate adjustment, or only upon final payment).
- 7. Constituents have raised concerns about disclosing potentially prejudicial information in financial statements. 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?**

In light of the FASB's re-deliberation of its project to amend disclosures of certain loss contingencies, it seems premature to require new disclosures in this FSP until those re-deliberations are complete. Therefore, we recommend that the FASB revise this FSP to require companies to follow the disclosure requirements in Statement 5 or "other GAAP" for contingencies acquired in a business combination until the Board's re-deliberations are complete.

If the FASB does not choose to wait until its loss contingency disclosures project is complete before requiring the proposed disclosures in the FSP, we are concerned that in certain situations the proposed disclosures could be prejudicial to a company. Therefore, we recommend that the FASB consider adding a prejudicial exemption to the FSP for instances in which the required disclosures would be prejudicial to a company.

Appendix B - Editorial Changes:
Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise From Contingencies – an amendment of FASB Statement No.141(R)

We recommend the following editorial changes be made and that the FASB consider our request for clarification indicated below while drafting the final FSP:

- Paragraph 9 of the proposed FSP indicates that the fair value of an asset or a liability arising from a contingency is reasonably determinable if a price for an identical asset or liability, or a similar asset or liability, can be observed in the marketplace. We understand that the Board's intent is to provide similar guidance to that provided in Statement 157 as it relates to the valuation of contingent assets and liabilities. We recommend that the FASB link the guidance in paragraphs 9 and 10 of the proposed FSP to Statement 157 to reduce the potential for readers to believe that a new fair value framework has been established. To the extent possible, the language from Statement 157, paragraphs 24 through 30, which focus on level 1, 2 and 3 inputs, should be utilized to limit differences in interpretation between Statement 157 and the FSP.

- Paragraph 14 should be amended as follows:

"if the acquisition-date fair value of ~~an asset acquired~~ or a liability assumed or an asset acquired in a business combination that arises from a contingency cannot be reasonably determined during the measurement period, the acquirer shall 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 that assets (hereafter referred to as "future settlement amount")."

We believe this change would make it clear that companies should use the same methodology for contingent assets acquired that a company would use to recognize and measure a contingent liability in accordance with Statement 5 and Interpretation 14, in which fair value cannot be reasonably determined.

- The last sentence of paragraph 16 refers to "other GAAP" (including Statement 5), whereas the preceding paragraphs seem to indicate that Statement 5 should be utilized. We believe the references should be consistent and would recommend they be conformed to include "other GAAP". This would enable the use of other appropriate recognition and measurement principles that a company would have consistently applied to similar contingencies rather than requiring application of FAS 5. If the Board were to conclude that Statement 5 must be applied to acquired contingencies that are scoped out of the fair value measurement, the reasons for that decision should be made clear.
- Paragraph 27.b. refers to liabilities recognized at fair value on the acquisition date. We believe this paragraph should also be updated to include assets recognized at fair value on the acquisition date. In addition, we recommend that paragraph 27.b. be clearer that its provisions relate to instances where a company changes its measurement of an asset or liability during the reporting period from the acquisition-date fair value to the amount recognized under Statement 5 and Interpretation 14. As written, readers may interpret the wording to mean that disclosure is required for all acquired contingencies where the acquisition date fair value and the Statement 5 and Interpretation 14 amount are different, even if the asset or liability was not adjusted to its Statement 5 and Interpretation 14 amount because there was no new information available. Therefore, we recommend the following edits to paragraph 27.b.:

For assets and liabilities recognized at fair value at the acquisition date, if there has been a change in the measurement of the asset or liability during the reporting period from the acquisition-date fair value to the future settlement amount ~~that would be~~ or the amount recognized under if apply Statement 5 and Interpretation 14, the amount of the change and the reason for the change.