FASB STAFF POSITION

No. FAS 141(R)-1

Title: Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies

Date Issued: April 1, 2009

Objective

1. This FASB Staff Position (FSP) amends and clarifies FASB Statement No. 141 (revised 2007), *Business Combinations*, to address application issues raised by preparers, auditors, and members of the legal profession on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination.

Background

2. Statement 141(R) was issued in December 2007 and is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. As issued, Statement 141(R) required that all contractual contingencies and all noncontractual contingencies that are more likely than not to give rise to an asset or liability as defined in FASB Concepts Statement No. 6, *Elements of Financial Statements*, be recognized at their acquisition-date fair value. All noncontractual contingencies that do not meet the more-likely-than-not criterion as of the acquisition date would be accounted for in accordance with other U.S. generally accepted accounting principles (GAAP), as appropriate, including FASB Statement No. 5, *Accounting for Contingencies*.

3. Absent new information about the possible outcome of a contingency, Statement 141(R) required that an asset or a liability arising from a contingency that was recognized at fair value as of the acquisition date continue to be reported at its acquisition-date fair value. Statement 141(R) required that when new information is obtained, a liability be measured at the higher of its acquisition-date fair value and the amount that would be

recognized by applying Statement 5. An asset would be measured at the lower of its acquisition-date fair value and the best estimate of its future settlement amount. An asset or liability arising from a preacquisition contingency would be derecognized only when the contingency is resolved.

4. Subsequent to the issuance of Statement 141(R), preparers, auditors, and members of the legal profession expressed concerns about the application of Statement 141(R) to assets and liabilities arising from contingencies in a business combination. Application issues included the following:

a. Determining the acquisition-date fair value of a litigation-related contingency
b. Supporting the recognition and measurement of liabilities arising from legal contingencies when supporting information may be subject to attorney-client privilege
c. Distinguishing between a contractual and noncontractual contingency
d. Dealing with situations in which a target entity may have determined that a loss contingency should be recognized in accordance with Statement 5 because the entity intends to settle out of court but the liability does not meet the more-likely-than-not threshold for recognition of a noncontractual contingency
e. Derecognizing a liability arising from a contingency recognized as of the acquisition date
f. Disclosing potentially prejudicial information in financial statements
g. Determining whether to account for contingent consideration arrangements of an acquiree assumed by the acquirer in a business combination in accordance with the guidance for contingent consideration or in accordance with the guidance for other assets and liabilities arising from contingencies.

5. In response to the application issues raised, a project was added to the Board's agenda in October 2008 to amend the initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination.

All paragraphs in the FSP have equal authority.
Paragraphs in bold set out the main principles.

FASB Staff Position

Scope

6. **This FSP applies to all assets acquired and liabilities assumed in a business combination that arise from contingencies that would be within the scope of Statement 5 if not acquired or assumed in a business combination, except for assets or liabilities arising from contingencies that are subject to specific guidance in Statement 141(R).** For example, Statement 141(R) provides separate specific guidance for the following:

a. Paragraphs 29, 30, and 64 separately address the accounting for indemnification assets.
b. Paragraphs 41, 42, and 65 address contingent consideration arrangements.
c. Paragraph A57 prohibits the recognition of a separate valuation allowance as of the acquisition date for assets acquired in a business combination, such as receivables, that are measured at acquisition-date fair values because the effects of uncertainty about future cash flows are included in the fair value measurement.

Initial Recognition and Measurement

7. **An acquirer shall recognize at fair value, at the acquisition date, an asset acquired or a liability assumed in a business combination that arises from a contingency if the acquisition-date fair value of that asset or liability can be determined during the measurement period.** For example, the acquisition-date fair value of a warranty obligation often can be determined.

8. **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 determined during the measurement period, an asset or a liability shall be recognized at the acquisition date if both of the following criteria are met:**

a. **Information available before the end of the measurement period indicates that it is probable that an asset existed or that a liability had been incurred at the acquisition date.** It is implicit in this condition that it must be probable at the acquisition date that one or more future events confirming the existence of the asset or liability will occur.

b. **The amount of the asset or liability can be reasonably estimated.**

Criteria (a) and (b) shall be applied using the guidance in Statement 5 and in FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss,* for application of similar criteria in paragraph 8 of Statement 5.

9. If neither the criterion in paragraph 7 nor the criteria in paragraph 8 are met at the acquisition date using information that is available during the measurement period about facts and circumstances that existed as of the acquisition date, the acquirer shall not recognize an asset or liability as of the acquisition date. In periods after the acquisition date, the acquirer shall account for an asset or a liability arising from a contingency that does not meet the recognition criteria at the acquisition date in accordance with other applicable GAAP, including Statement 5, as appropriate.

10. **Contingent consideration arrangements of an acquiree assumed by the acquirer in a business combination shall be recognized initially at fair value in accordance with the guidance for contingent consideration arrangements in Statement 141(R).**

Subsequent Measurement and Accounting

11. **An acquirer shall develop a systematic and rational basis for subsequently measuring and accounting for assets and liabilities arising from contingencies depending on their nature.**

12. **Contingent consideration arrangements of an acquiree assumed by the acquirer in a business combination shall be measured subsequently in accordance with the guidance for contingent consideration arrangements in paragraph 65 of Statement 141(R).**

Disclosures

13. **An acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effects of a business combination**

that occurs either during the current reporting period or after the reporting period but before the financial statements are issued.

14. For each business combination that occurs during the reporting period, an acquirer shall disclose the following in the footnote that describes the business combination:

a. For assets and liabilities arising from contingencies recognized at the acquisition date:
   (1) The amounts recognized at the acquisition date and the measurement basis applied (that is, at fair value or at an amount recognized in accordance with Statement 5 and Interpretation 14)
   (2) The nature of the contingencies.

   An acquirer may aggregate disclosures for assets or liabilities arising from contingencies that are similar in nature.
b. For contingencies that are not recognized at the acquisition date, the disclosures required by Statement 5 if the criteria for disclosures in that Statement are met.

Effective Date and Transition

15. **This FSP shall be effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008.**

The provisions of this FSP need not be applied to immaterial items.

This FSP was adopted by the affirmative votes of four members of the Financial Accounting Standards Board. Mr. Linsmeier dissented.

Mr. Linsmeier dissents from issuance of this FSP because it fails to provide guidance in two key areas, and, therefore, he does not believe the FSP will be operational. First, this FSP requires that an acquirer recognize at fair value an asset acquired or a liability assumed in a business combination that arises from a contingency if the acquisition-date fair value of that asset or liability can be determined during the measurement period without providing guidance as to how to make this assessment. This assessment drives the key differences in the accounting prescribed by this FSP and, if not clear, is likely to raise significant application and comparability issues. Statement 157 provides guidance on how to determine fair value in active and inactive markets and in the presence of both observable inputs and unobservable inputs, which might suggest that fair value should be able to be determined in many, if not most, circumstances. Mr. Linsmeier is concerned that without providing guidance on how to make this determination assessment the Board is being unclear about its intentions, introducing significant judgment in the application of this FSP that will not result in consistent reporting across enterprises.

Second, this FSP does not prescribe in detail how an asset or a liability arising from a contingency initially recognized at fair value in a business combination would be measured subsequent to its initial recognition. This FSP only requires that an acquirer develop a systematic and rational basis for subsequently measuring and accounting for such assets and liabilities depending on their nature, suggesting in the basis for conclusions to this FSP that methods be developed similar to those prescribed in Interpretation 45. While not stated in this FSP, the Board in its deliberations leading to this FSP generally agreed that Statement 5 does not provide appropriate guidance for the subsequent accounting for an asset or a liability arising from a contingency initially recognized at fair value in a business combination. In addition, the majority of the Board did not support subsequent accounting at fair value for those assets and liabilities. The failure to make these tentative decisions authoritative in this FSP and the failure to provide further guidance on the subsequent accounting similar to Interpretation 45 are likely to result in multiple methods for accounting and reporting for identical assets acquired and liabilities assumed in a business combination subsequent to their initial recognition at fair value, causing significant comparability issues for financial statement users across enterprises.

As a consequence, Mr. Linsmeier believes this FSP fails to provide sufficient guidance to permit financial statement issuers and their auditors to consistently apply the guidance in this FSP and, as a result, financial statement users will not be provided useful and comparable information about the financial statement effects of assets acquired and liabilities assumed in a business combination that arise from contingencies.

Members of the Financial Accounting Standards Board:

Appendix A

AMENDMENTS TO EXISTING LITERATURE

A1. Statement 141(R) is amended as follows: [Added text is underlined and deleted text is ~~struck out~~.]

a. The heading directly following paragraph 22:

Exceptions to both the Recognition and Measurement Principles

b. Paragraph 24:

~~The guidance in Statement 5 **does not apply** in determining which assets or liabilities arising from contingencies to recognize as of the acquisition date. Instead:~~

~~a. The acquirer shall recognize as of the acquisition date all of the assets acquired and liabilities assumed that arise from contingencies related to contracts (referred to as *contractual contingencies*), measured at their acquisition-date fair values.~~

~~b. For all other contingencies (referred to as *noncontractual contingencies*), the acquirer shall assess whether it is **more likely than not** as of the acquisition date that the contingency gives rise to an asset or a liability as defined in Concepts Statement 6. If that criterion is met as of the acquisition date, the asset or liability arising from a noncontractual contingency shall be recognized at that date, measured at its acquisition-date fair value. If that criterion is not met as of the acquisition date, the acquirer shall not recognize an asset or a liability at that date. The acquirer shall instead account for a noncontractual contingency that does not meet the more-likely-than-not criterion as of the acquisition date in accordance with other GAAP, including Statement 5, as appropriate. Paragraphs A62–A65 illustrate the application of the more-likely-than-not criterion.~~

The acquirer shall recognize as of the acquisition date, assets acquired and liabilities assumed that would be within the scope of Statement 5 if not acquired or assumed in a business combination, except for assets or liabilities arising from contingencies that are subject to specific guidance in this Statement as follows:

a. If the acquisition-date fair value of the asset or liability arising from a contingency can be determined during the measurement period, that asset or liability shall be recognized at the acquisition date measured at fair value. For example, the acquisition-date fair value of a warranty obligation often can be determined.

b. If the acquisition-date fair value of the asset or liability arising from a contingency cannot be determined during the measurement period, an asset or a liability shall be recognized at the acquisition date if both of the following criteria are met:

(1) Information available before the end of the measurement period indicates that it is probable that an asset existed or that a liability had been incurred at the acquisition date. It is implicit in this condition that it must be probable at the acquisition date that one or more future events confirming the existence of the asset or liability will occur.

(2) The amount of the asset or liability can be reasonably estimated.

Criteria (1) and (2) shall be applied using the guidance in Statement 5 and in FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*, for application of similar criteria in paragraph 8 of Statement 5.

If neither criterion (a) nor criterion (b) is met at the acquisition date using information that is available during the measurement period about facts and circumstances that existed as of the acquisition date, the acquirer shall not recognize an asset or liability as of the acquisition date. In periods after the acquisition date, the acquirer shall account for an asset or a liability arising from a contingency that does not meet the recognition criteria at the acquisition date in accordance with other applicable GAAP, including Statement 5, as appropriate.

c. Paragraph 24A is added as follows:

Contingent consideration arrangements of an acquiree assumed by the acquirer in a business combination shall be recognized initially at fair value in accordance with the guidance for contingent consideration arrangements in paragraph 41.

d. Paragraph 25 and the heading following it:

~~In some situations, determining whether a contingency is contractual or noncontractual may require the exercise of judgment based on the facts and circumstances of the specific situation. Paragraphs 62 and 63 provide guidance on the subsequent accounting for assets and liabilities arising from contingencies that would be in the scope of Statement 5 if not acquired or assumed in a business combination.~~

~~***Exceptions to Both the Recognition and Measurement Principles***~~

e. Paragraph 30:

In some circumstances, the indemnification may relate to an asset or a liability that is an exception to the recognition or measurement principles. For example, an indemnification may relate to a ~~noncontractual~~ contingency that is not recognized at the acquisition date because it does not satisfy the ~~more-likely-than-not criterion~~ <u>criteria for recognition in paragraph 24</u> at that date. Alternatively, an indemnification may relate to an asset or a liability, for example, one that results from an uncertain tax position that is measured on a basis other than acquisition-date fair value (paragraphs 26 and 27). In those circumstances, the indemnification asset shall be recognized and measured using assumptions consistent with those used to measure the indemnified item, subject to management's assessment of the collectibility of the indemnification asset and any contractual limitations on the indemnified amount. Paragraph 64 provides guidance on the subsequent accounting for an indemnification asset.

f. Paragraph 60:

In general, an acquirer shall subsequently measure and account for assets acquired, liabilities assumed or incurred, and equity instruments issued in a business combination in accordance with other applicable GAAP for those items, depending on their nature (paragraph 66). However, this Statement provides guidance on subsequently measuring and accounting for the following assets acquired, liabilities assumed or incurred, and equity instruments issued in a business combination:

a. **Reacquired rights**
b. **Assets and liabilities arising from contingencies recognized as of the acquisition date**
c. **Indemnification assets**
d. **Contingent consideration**
e. **<u>Contingent consideration arrangements of an acquiree assumed by the acquirer</u>.**

g. Paragraph 62:

<u>An acquirer shall develop a systematic and rational basis for subsequently measuring and accounting for assets and liabilities arising from contingencies depending on their nature.</u>~~The subsequent accounting for an asset or a liability arising from a contingency recognized as of the acquisition date in accordance with paragraph 24 that would be in the scope of Statement 5 if not acquired or assumed in a business combination depends on when new information about the possible outcome of the contingency is obtained. Absent new information about the possible outcome, the acquirer shall continue to report such an asset or a liability at its acquisition-date fair value. When new information is obtained about the possible outcome of the contingency, the acquirer shall evaluate that information and measure the asset or liability as follows:~~

~~a. A liability shall be measured at the **higher** of:~~
~~(1) Its acquisition-date fair value; or~~
~~(2) The amount that would be recognized if applying Statement 5.~~
~~b. An asset shall be measured at the **lower** of:~~
~~(1) Its acquisition-date fair value; or~~
~~(2) The best estimate of its future settlement amount.~~

h. Paragraph 63:

~~The acquirer shall derecognize an asset or a liability arising from a contingency only when the contingency is resolved, for example, when the acquirer collects the asset, sells it, or otherwise loses the right to it or when the acquirer settles the liability, or its obligation to settle it is cancelled or expires.~~

i. Paragraph 65A is added as follows:

Contingent consideration arrangements of an acquiree assumed by the acquirer in a business combination shall be measured subsequently in accordance with the guidance for contingent consideration arrangements in paragraph 65.

j. Paragraph 68(j):

For assets and liabilities arising from contingencies recognized at the acquisition date:

(1) The amounts recognized at the acquisition date ~~or an explanation of why no amount was recognized (paragraph 24)~~ and the measurement basis applied (that is, at fair value or at an amount recognized in accordance with Statement 5 and Interpretation 14)
(2) The nature of the~~recognized and unrecognized~~ contingencies.
~~(3) An estimate of the range of outcomes (undiscounted) for contingencies (recognized and unrecognized) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated.~~

An acquirer may aggregate disclosures for assets ~~and~~or liabilities arising from contingencies that are similar in nature.

k. Paragraph 68(j)(j) is added as follows:

For assets and liabilities arising from contingencies that have not been recognized at the acquisition date, the disclosures required by Statement 5 if the criteria for disclosures in that Statement are met. The disclosures required, if any, by this paragraph and by paragraph 68(j) shall be included in the footnote that describes the business combination.

l. Paragraph 72(c):

~~For each reporting period after the acquisition date until the acquirer collects, sells, or otherwise loses the right to recognized assets arising from contingencies, or the acquirer settles recognized liabilities or its obligation to settle them is cancelled or expires:~~

~~(1) Any changes in the recognized amounts of assets and liabilities arising from contingencies and the reasons for those changes~~

~~(2) Any changes in the range of outcomes (undiscounted) for both recognized and unrecognized assets and liabilities arising from contingencies and the reasons for those changes.~~

m. Paragraph A62:

~~Paragraph 24 establishes a *more-likely-than-not* criterion to determine whether to recognize as of the acquisition date an asset or a liability arising from a noncontractual contingency. If that criterion is not met as of the acquisition date, the noncontractual contingency is recognized and measured at a later date in accordance with other GAAP, including FASB Statement No. 5, *Accounting for Contingencies*, as appropriate.~~

n. Paragraph A63:

~~This Statement uses *more likely than not* for a purpose that differs from the purpose of the probability notion in the definition of assets and liabilities in FASB Concepts Statement No. 6, *Elements of Financial Statements*. For example, Concepts Statement 6 defines liabilities as:~~

> ~~probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events. [Paragraph 35; footnote references omitted.]~~

~~Thus, *probable* applies to the future sacrifice of economic benefits embodied in the liability; it does not apply directly to whether the entity has a *present obligation*. A footnote to paragraph 35 of Concepts Statement 6 explains that *probable* is used in the definition "to acknowledge that business and other economic activities occur in an environment characterized by uncertainty in which few outcomes are certain" (paragraph 35, footnote 21). In contrast, the more-likely-than-not criterion in this Statement applies to whether the acquirer has incurred an obligation to pay if a specified event—the contingency—occurs. The criterion asks: Is it more likely than not that the entity has a present obligation. If that threshold is met, uncertainties about the amount and timing of the future cash flows—the future sacrifice—embodied in a liability arising from a contingency are incorporated in its fair value measure. The same analysis applies equally to an asset arising from a contingency.~~

o. Paragraph A64 and the heading preceding it:

~~Example 1: A Liability Arising from a Noncontractual Contingency~~

~~In December 20X8, a former employee filed suit against TC alleging violation of age discrimination laws. On January 30, 20X9, AC purchases all of TC's outstanding equity shares for cash. As of the acquisition date, discovery~~

~~proceedings related to the discrimination lawsuit were underway but were not yet complete. TC's management asserts that its hiring and promotion practices complied with all applicable laws and regulations.~~

p. Paragraph A65:

~~AC would recognize a liability as of the acquisition date, measured at its acquisition-date fair value, if it concludes based on the facts known as of that date that it is more likely than not that TC had violated the age discrimination laws. In making that assessment, AC would consider all relevant facts and circumstances, such as the results of discovery proceedings to date, advice from its lawyers about whether TC would be found liable based on the facts known at that date, and any other relevant information gathered through due diligence or other procedures. However, neither a past practice of settling similar suits out of court nor consideration of an out-of-court settlement of the lawsuit against TC, in and of itself, provides a conclusive basis for recognizing a liability. Rather, AC would consider such information together with other evidence in determining whether it is more likely than not that TC has violated the applicable laws or regulations and is likely to be found liable under the lawsuit. The acquisition-date fair value measure of the recognized liability, if any, would reflect possible outcomes of the litigation, including possible out-of-court settlement.~~

q. Paragraph A107:

[For ease of use, only the portions of this paragraph affected by this FSP have been reproduced.]

68(j)~~, 72(c)~~ A liability of $1,000 has been recognized at fair value for expected warranty claims on products sold by TC during the last 3 years. AC expects that the majority of this expenditure will be incurred in 20X3 and that all will be incurred by the end of 20X4. ~~The potential undiscounted amount of all future payments that AC could be required to make under the warranty arrangements is estimated to be between $500 and $1,500. As of December 31, 20X2, there has been no change since June 30, 20X2, in the amount recognized for the liability or any change in the range of outcomes or assumptions used to develop the estimates.~~

r. In the table in Appendix G, the guidance titled, "Assets and liabilities arising from contingencies":

Under the heading for Statement 141(R):

Initial Recognition

Statement 141(R) requires the acquirer to recognize as of the acquisition date ~~the~~ assets acquired and liabilities assumed that arise from ~~*contractual*~~ *contingencies*~~,~~ ~~measured~~ at their acquisition-date fair values if their acquisition-date fair values can be determined during the measurement period. ~~For all other contingencies~~

~~(referred to as *noncontractual contingencies*), the acquirer recognizes an asset or liability as of the acquisition date if it is **more likely than not** that the contingency gives rise to an asset or a liability as defined in FASB Concepts Statement No. 6, *Elements of Financial Statements*.~~ If the acquisition-date fair value of an asset or a liability cannot be determined during the measurement period, the acquirer shall recognize an asset or a liability at the acquisition date if (a) information available before the end of the measurement period indicates that it is probable that an asset existed or that a liability had been incurred at the acquisition date and (b) the amount of the asset or liability can be reasonably estimated. The asset or liability shall be measured using the guidance provided in FASB Statement No. 5, *Accounting for Contingencies*, and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*, for application of similar criteria in paragraph 8 of Statement 5. ~~Noncontractual~~ C~~c~~ontingencies that do not meet the recognition ~~threshold~~criteria as of the acquisition date are not recognized at the acquisition date and are accounted for in accordance with other applicable GAAP, including ~~FASB~~ Statement ~~No.~~ 5, ~~*Accounting for Contingencies,*~~ as appropriate. [paragraphs 23~~–25~~ and 24]

Subsequent Measurement

Statement 141(R) requires that an acquirer develop a systematic and rational basis for subsequently measuring and accounting for assets and liabilities arising from contingencies depending on their nature. ~~requires that an acquirer continue to report an asset or liability arising from a contractual or noncontractual contingency that is recognized as of the acquisition date that would be in the scope of Statement 5 if not acquired or assumed in a business combination at its acquisition-date fair value until the acquirer obtains new information about the possible outcome of the contingency. The acquirer evaluates that new information and measures the asset or liability as follows:~~

- ~~a. A liability is measured at the **higher** of:~~
  - ~~(1) Its acquisition-date fair value; or~~
  - ~~(2) The amount that would be recognized if applying Statement 5.~~
- ~~b. An asset is measured at the **lower** of:~~
  - ~~(1) Its acquisition-date fair value; or~~
  - ~~(2) The best estimate of its future settlement amount.~~

[paragraph~~s~~ 6~~2~~0~~ and 63~~]

Disclosures

For an asset or liability arising from a contingency recognized at the acquisition date, Statement 141(R)~~'s~~ requires that the acquirer disclose the nature of the contingency, the amount recognized, and the measurement basis applied. For contingencies that are not recognized at the acquisition date, Statement 141(R) requires that the acquirer include the disclosures required by Statement 5 in the footnote that describes the business combination.~~disclosures related to assets and liabilities arising from contingencies are slightly different from those required by~~

~~the revised IFRS 3 because the IASB's disclosures are based on the requirements in IAS 37.~~ [~~Statement 141(R),~~ paragraphs 68(j) and 68(j)(j)~~72(c); the revised IFRS 3, paragraphs B64(j) and B67(c)~~]

Under the heading for IFRS 3 (as revised in 2007):

Disclosures

The revised IFRS 3 carries forward the existing disclosure requirements in IAS 37 and requires an acquirer to disclose the reasons that the fair value of a contingent liability cannot be measured reliably, if applicable. [paragraphs B64(j) and B67(c)]

Under the heading for Statement 141(R) and IFRS 3 (as revised in 2007):

~~**Implementation Guidance**~~

~~Statement 141(R) provides implementation guidance for applying the more-likely-than-not criterion for recognizing noncontractual contingencies. The revised IFRS 3 does not have equivalent guidance. [Statement 141(R), paragraphs A62–A65]~~

A2. FASB Statement No. 5, *Accounting for Contingencies*, is amended as follows:

a. Paragraph 7A, as added:

This Statement does not apply to the initial recognition of assets or liabilities arising from contingencies~~contingent gains or losses~~ that are recognized at fair value or assets arising from contingencies recognized at an amount other than fair value on the acquisition date in a business combination. FASB Statement No. 141 (revised 2007), *Business Combinations*, provides the ~~subsequent accounting~~initial recognition and ~~disclosure~~measurement requirements for assets and liabilities arising from contingencies~~contingent gains or losses~~ recognized at fair value and for assets arising from contingencies recognized at an amount other than fair value as part of a business combination.~~ This Statement does, however, apply to contingent gains or losses that were acquired or assumed in a business combination but that were not recognized at the acquisition date because they did not meet the recognition threshold in Statement 141(R) at that date.~~

A3. FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*, is amended as follows:

a. Paragraph 59D, as added:

Other related contracts that are not insurance or reinsurance contracts shall be recognized and measured at the date of acquisition in accordance with FASB Statement No. 141 (revised 2007), *Business Combinations*. For example, a contingent commission arrangement is a ~~contractual~~ contingency that the acquirer shall account for in accordance with paragraph 24 of Statement 141(R). An example of an indemnification agreement that may be in the form of a reinsurance contract is a guarantee by the seller of the adequacy of acquired claims and claims expense liabilities at the date of acquisition. The acquirer shall recognize any indemnification asset resulting from such an agreement in accordance with paragraphs 29 and 30 of Statement 141(R).

Appendix B

BASIS FOR CONCLUSIONS

Introduction

B1. This appendix summarizes considerations that Board members deemed significant in reaching the conclusions in this FSP. It includes the reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Initial Recognition and Measurement of Assets and Liabilities Arising from Contingencies

B2. The 2005 FASB Exposure Draft, *Business Combinations,* proposed that an acquirer recognize all assets and liabilities arising from an acquiree's contingencies if they meet the definition of an asset or a liability in Concepts Statement 6 regardless of whether a contingency meets the recognition criteria in Statement 5. The Board concluded, in principle, that to faithfully represent the acquirer's economic circumstances resulting from the business combination at the acquisition date, all identifiable assets acquired and liabilities assumed should be recognized separately from goodwill, including assets and liabilities arising from contingencies at the acquisition date.

B3. Respondents to the 2005 Exposure Draft expressed concerns about how to deal with uncertainty regarding whether and when a contingency gives rise to an asset or a liability that meets the definitions in Concepts Statement 6, which is referred to as *element uncertainty*. Respondents also were concerned about the ability to reliably measure the fair value of assets and liabilities arising from contingencies at the acquisition date. Respondents suggested several means of dealing with element uncertainty, which generally involved placing a threshold either on all contingencies or on the noncontractual contingencies that an acquirer is required to recognize at the acquisition date (for example, requiring recognition only if the contingency is more likely than not to give rise to an asset or a liability). Other respondents suggested requiring recognition of only those assets and liabilities arising from contingencies whose fair values can be reliably determined, which would be similar to the requirements of FASB Statement No. 141, *Business Combinations*.

B4. In its redeliberations of the 2005 Exposure Draft, the Board decided to directly address element uncertainty, which also would indirectly address reliable measurement concerns. The Board concluded that most cases of significant uncertainty about whether a potential asset or liability arising from a contingency meets the pertinent element definition (element uncertainty) are likely to involve noncontractual contingencies. To help preparers and auditors deal with element uncertainty, the Board decided to add a criterion for the acquirer to assess whether it is more likely than not as of the acquisition date that the noncontractual contingency gives rise to an asset or a liability as defined in Concepts Statement 6. If that criterion was met at the acquisition date, the acquirer would recognize the asset or liability, measured at its acquisition-date fair value, as part of the accounting for the business combination. If that criterion was not met at the acquisition date, the acquirer would not recognize an asset or a liability at that date. Instead, the acquirer would account for a noncontractual contingency that does not meet the more-likely-than-not criterion as of the acquisition date in accordance with other GAAP, including Statement 5, as appropriate.

B5. The Board concluded that sufficient information was likely to be available to measure the acquisition-date fair value of assets and liabilities arising from contractual contingencies and noncontractual contingencies that satisfy the more-likely-than-not criterion. The Board used a similar approach (that is, distinguishing between contractual and noncontractual) in developing the guidance in Statement 141 for identifying intangible assets to be recognized apart from goodwill. The Board acknowledged that noncontractual assets and liabilities that do not meet the more-likely-than-not criterion at the acquisition date are likely to raise difficult measurement issues and concerns about the reliability of those measures. To address those reliability concerns, the Board decided that an acquirer should not measure and recognize such assets and liabilities at the acquisition date.

B6. After the issuance of Statement 141(R), preparers, auditors, and attorneys raised a number of application issues about the requirements in that Statement related to assets and liabilities arising from contingencies. In particular, preparers and attorneys were concerned about providing auditors with evidence to support the recognition and measurement of liabilities related to certain litigation-related loss contingencies assumed in a business combination under Statement 141(R), because disclosure of such information could be prejudicial.

B7. Preparers and attorneys were concerned that information provided to an independent auditor about whether it is more likely than not that a litigation-related contingent liability exists under Concepts Statement 6 could lose its privileged status and be subject to discovery. Attorneys indicated that if an acquirer recognizes a liability arising from a litigation-related 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. The American Bar Association's *Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information* does not require a client's attorney to comment on whether it is more likely than not that a contingency arising from litigation gives rise to a liability as defined in Concepts Statement 6. Attorneys indicated that they could not reconcile fulfilling their professional responsibilities to their clients and providing auditors with audit evidence that states that their client is more likely than not liable in a given case.

B8. Preparers and attorneys also noted that legal contingencies are subject to a significant number of noneconomic factors, and expressed concerns about an acquirer's ability to reliably determine the acquisition-date fair value of assets and liabilities arising from legal contingencies, even if it is more likely than not that those contingencies meet the elements definition. Because of the number of variables and assumptions involved in assessing the possible outcomes of a legal dispute, particularly in the early stages, individual attorneys are much more likely to develop significantly different assessments of the fair value of a legal contingency than individual valuation professionals determining the fair value of other assets and liabilities that involve unobservable inputs (for example, an identifiable intangible asset).

B9. In addition to raising concerns about litigation-related contingencies, preparers and auditors raised concerns about determining when a contingency should be considered contractual or noncontractual because of the different recognition thresholds for contractual and noncontractual contingencies. Some constituents also expressed concerns about situations in which a target entity may have determined that a loss contingency should be recognized in accordance with Statement 5 because the entity intends to settle out of court. In those situations, the liability does not meet the more-likely-than-not threshold for recognition of a noncontractual contingency because Statement 141(R) does not permit an acquirer to consider a potential out-of-court settlement as a conclusive basis for recognizing a liability.

B10. Statement 141 required that an asset or a liability arising from a contingency be recognized at fair value if fair value can be determined. In the deliberations leading to this FSP, the Board decided to adopt a model similar to the guidance in Statement 141 to address the application issues raised by constituents. The Board considers this change to be a temporary solution until it determines whether to separately address the accounting for all contingencies by reconsidering Statement 5 or by participating in the IASB's project on their Exposure Draft, *Amendments to IAS 37 Provisions, Contingent Liabilities and Contingent Assets and IAS 19 Employee Benefits*.

B11. Statement 157 provides a framework for measuring fair value. Paragraph 2 of Statement 157 indicates that the Statement does not eliminate the practicability exceptions to fair value measurements in accounting pronouncements within its scope, including Statements 141 and 141(R). The proposed FSP would have required that an asset or a liability arising from a contingency be recognized at fair value if fair value could be *reasonably determined.* It also included guidance for assessing whether the fair value of an asset or liability arising from a contingency that was based on existing guidance in FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations*, could be reasonably determined. Interpretation 47 addresses situations in which sufficient information may not be available to make a reasonable estimate of the fair value of an asset retirement obligation. The Board decided that it would be useful to provide additional guidance for assessing whether the fair value of an asset or liability arising from a contingency can be reasonably determined and measured in accordance with Statement 157.

B12. Many respondents to the proposed FSP commented on the complexity in the proposed initial and subsequent accounting for assets and liabilities arising from contingencies. During its redeliberations, the Board noted that significant practice issues related to assets and liabilities arising from contingencies under Statement 141 did not appear to exist. The Board concluded that the general requirements in Statement 141 for accounting for assets and liabilities arising from contingencies should be carried forward without significant revision. However, footnote 14 of Statement 141, which provided an example of when fair value of a contingency can be determined, was not carried forward because it is inconsistent with the exit price notion of Statement 157. The Board also decided not to carry forward the guidance in Statement 141 specific to warranties, which required that warranty obligations be recognized at present values of amounts to be paid determined at appropriate current interest rates. The Board believes that acquirers often will have the information necessary to determine the fair value of warranty obligations assumed in a business combination.

Subsequent Measurement and Accounting

B13. The 2005 Exposure Draft for Statement 141(R) proposed that assets and liabilities arising from contingencies recognized at the acquisition date should be subsequently measured at fair value. The Board ultimately decided not to require subsequent measurement at fair value, primarily because it would result in different measurements of (a) assets and liabilities arising from contingencies acquired in a business combination and (b) other similar assets and liabilities not acquired in a business combination, which would make financial reports more difficult to understand. As a practical alternative, the Board decided during redeliberations of Statement 141(R) to require the acquirer to continue to report an asset or a liability arising from a contingency recognized as of the acquisition date at its acquisition-date fair value absent new information about the possible outcome of the contingency. When such new information was obtained, the acquirer would evaluate that information and measure the asset or liability as follows:

a. A liability would be measured at the *higher* of either:
   (1) Its acquisition-date fair value; or
   (2) The amount that would be recognized if applying Statement 5.
b. An asset would be measured at the *lower* of either:
   (1) Its acquisition-date fair value; or
   (2) The best estimate of its future settlement amount.

B14. The Board concluded that this alternative provided a practical bridge between improved reporting at the acquisition date and subsequent accounting under the existing requirements of Statement 5.

B15. The Board also concluded in its deliberations of Statement 141(R) that an asset or a liability arising from a contingency recognized at the acquisition date should be derecognized only when the contingency is resolved. Statement 141(R) provided examples of when a contingency is resolved, including when an acquirer settles a liability or when its obligation to settle the liability is cancelled or expires.

B16. After the issuance of Statement 141(R), preparers and auditors raised concerns about the application of the subsequent measurement and accounting guidance in situations in which the contingency is resolved over time or in which there is a lack of 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. Those constituents were concerned that Statement 141(R) did not allow for a liability assumed in a business combination that arises from a contingency to be reduced below its acquisition-date fair value until the liability is completely settled or its potential obligation is cancelled or expires.

B17. Although it was not clear, the Board did not intend that the subsequent measurement and accounting guidance in Statement 141(R) should require that a liability arising from a contingency be recognized at its acquisition-date fair value until the contingency is completely resolved if the acquirer is released from risk over time or fulfills its performance obligation over time. In the deliberations leading to the proposed

FSP, the Board observed that the guidance in IFRS 3, *Business Combinations,* as revised in 2007, related to contingent liabilities appears to address this issue. Revised IFRS 3 requires that a contingent liability recognized in a business combination be measured at the higher of (a) the amount that would be recognized in accordance with IAS 37, *Provisions, Contingent Liabilities and Contingent Assets,* and (b) the amount initially recognized less, if appropriate, cumulative amortization recognized in accordance with IAS 18, *Revenue*. The Board decided to include clarifying language in the proposed FSP to allow an acquirer to reflect its release from risk or performance under the obligation over time.

B18. In the proposed FSP, the Board also decided to clarify that the acquirer may derecognize a liability arising from a contingency (that is, the contingency would be considered resolved) when the acquirer obtains new information that indicates there is only a remote possibility that the obligation will be enforced (that is, performance would not be required). The Board believed this change addressed concerns about the lack of clear resolution of a contingency when the acquirer does not believe settlement will ever be required and the liability is not subject to cancellation or expiration.

B19. Respondents commented on the complexity of the subsequent accounting guidance, which was illustrated in three pages of decision trees. Respondents also requested that the Board provide additional clarification to the subsequent accounting guidance in the proposed FSP, including whether a liability recognized at fair value should be accreted if no new information about the possible outcome of the contingency has been obtained and whether new information could include the passage of time. Respondents also expressed concerns that the proposed FSP did not allow for a decrease in a liability that is recognized at the acquisition date if the entity's estimate of the liability changes.

B20. The Board decided to adopt a model similar to the guidance in Statement 141 for the initial recognition and measurement of assets and liabilities arising from contingencies in a business combination. Statement 141 did not provide subsequent accounting guidance for assets and liabilities arising from contingencies. Therefore, the Board decided to eliminate from Statement 141(R) the specific subsequent accounting guidance for assets and liabilities arising from contingencies in a business combination. Because practice already exists for subsequent accounting for assets and liabilities arising from contingencies recognized in accordance with Statement 141, the Board does not believe it was necessary to provide specific subsequent accounting guidance. The Board acknowledges that because the guidance in Statement 141 related to warranties was not carried forward to Statement 141(R), warranty obligations assumed in a business combination often will be initially recognized at fair value. Although practice does not currently exist for subsequently accounting for warranty obligations initially recognized at fair value, the Board believes that acquirers can develop a systematic and rational method for subsequently accounting for these liabilities similar to methods that have been developed to subsequently account for guarantees that are initially recognized at fair value under FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*.

Contingent Consideration of an Acquiree

B21. After the issuance of Statement 141(R), constituents questioned whether contingent consideration arrangements of an acquiree assumed in a business combination (that is, the acquiree previously acquired another business and the arrangement included contingent consideration) should be accounted for as contingent consideration or in accordance with the guidance for assets and liabilities arising from contingencies in a business combination. Those constituents argued that the contingent consideration obligation of an acquiree should not be considered contingent consideration of the acquirer because the acquirer is not obligated to transfer additional assets or equity interest to the former owners of the acquiree (that is, the arrangement does not appear to meet the definition of contingent consideration in paragraph 3(f) of Statement 141(R)).

B22. The Board believes that the nature of contingent consideration does not change on subsequent acquisition of one entity by another entity (that is, although the amount of the future payments the acquirer will make is conditional on future events, the obligation to make them if the specified future events occur is unconditional). Therefore, the Board concluded that a contingent consideration arrangement of an acquiree assumed by the acquirer in a business combination should be accounted for in the same manner as a contingent consideration.

Disclosures

B23. After the issuance of Statement 141(R), constituents raised concerns about the disclosure requirements for assets and liabilities arising from contingencies in a business combination. Specifically, constituents were concerned that defendants in a lawsuit would be required to disclose prejudicial information about litigation-related contingencies. For example, requiring an acquirer to disclose the amounts recognized for a contingency could be considered prejudicial because it informs the plaintiff that an accrual has been made, which could effectively set a floor for settlement negotiations. Additionally, constituents were concerned about the requirement for entities to disclose the nature of recognized and unrecognized contingencies without a threshold for the disclosure because entities would be required to disclose unasserted claims or assessments even when the chances of a claim being asserted are less than reasonably possible. Such disclosure is inconsistent with the existing guidance in Statement 5. Respondents to the proposed FSP also were concerned with the requirement to disclose a range of expected outcomes and changes in those ranges. Statement 5 allows entities to state that an estimate of the possible loss or range of loss cannot be made, and respondents argued that often it will not be possible to make such an estimate.

B24. The Board currently has a project on its agenda to enhance the disclosure of certain loss contingencies, including contingencies arising from a business combination. The Board believes the requirement to disclose the amount recognized at the acquisition date is consistent with the requirement in Statement 5 to disclose the amount accrued if the financial statements would be misleading without it. However, the Board decided to eliminate the requirement in Statement 141(R) to disclose a range of expected outcomes and changes in those ranges. Additionally, to address concerns about prejudicial information about unrecognized liabilities arising from contingencies, the Board decided not to require any disclosures beyond those required in Statement 5 for such liabilities. For each business combination that occurs during the reporting period, the Board decided that the disclosures required in Statement 5 should be included in the financial statement footnote that describes the business combination.

B25. The proposed FSP required that assets and liabilities arising from contingencies be recognized at fair value if fair value could be reasonably determined. The Board initially decided to require disclosure of the reasons that the fair value of an asset or a liability could not be reasonably determined. However, based on respondents' comments that such a disclosure may be prejudicial, the Board decided not to require this additional disclosure. The Board also concluded that entities should subsequently apply the disclosure requirements of other applicable GAAP, including Statement 5, as appropriate. Therefore, the Board decided to eliminate the requirement to disclose any changes in the recognized amounts of assets and liabilities arising from contingencies and the reasons for those changes.

Benefits and Costs

B26. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Current and potential investors, creditors, and other users of financial information benefit from the improvements in financial reporting, while the costs to implement a new standard are borne primarily by current investors. The Board's assessment of the costs and benefits of issuing an accounting standard is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement an accounting standard or to quantify the value of improved information in financial statements.

B27. It is likely that fewer assets and liabilities arising from contingencies will be separately recognized and initially measured at fair value under this FSP than would have been recognized under the original requirements of Statement 141(R). Therefore, it is expected that the costs of implementing this FSP will be less than the costs of implementing the original requirements in Statement 141(R). However, the Board believes that more assets and liabilities arising from contingencies will be separately recognized and initially measured at fair value under this FSP than have historically been recognized under Statement 141 because of Statement 141's requirement that accruals for warranties be recognized at other than fair value, which was not carried forward in Statement 141(R). Therefore, the Board acknowledges that there will be costs associated with applying the provisions of this FSP. The Board also acknowledges that there will be costs associated with developing a systematic and rational method for subsequently accounting for assets and liabilities initially recognized at fair value.

B28. The Board acknowledges that this FSP does not provide investors, creditors, and other users of financial statements with some information that would have been provided had Statement 141(R) not been amended. However, because this FSP will continue to require that an acquirer disclose the amount of the asset or liability recognized at the acquisition date and the nature of the contingency, investors, creditors, and other users of financial statements will receive more information than they received under Statement 141. The Board believes the changes to Statement 141(R) made by this FSP were necessary to address operational issues raised by various constituents that could have resulted in significant costs to preparers.

International Financial Reporting Standards

B29. The guidance for accounting for assets and liabilities arising from contingencies in a business combination in Statement 141(R) and in revised IFRS 3 did not converge before the issuance of this FSP. This FSP eliminates the distinction between a contractual and noncontractual contingency and the more-likely-than-not threshold for the recognition of noncontractual contingencies in Statement 141(R), which are not included in the revised IFRS 3. This FSP requires that an asset or a liability arising from a contingency be recognized at fair value if its fair value can be determined, which is similar to the requirement in revised IFRS 3 to recognize a contingent liability assumed in a business combination if its fair value can be measured reliably. However, the Board believes that the fair value of an asset or liability arising from a contingency often will not be determinable, particularly for legal contingencies. Because IAS 37 indicates that, except in extremely rare cases, it should be possible for an entity to determine a range of possible outcomes and, therefore, to make an estimate of the obligation that is sufficiently reliable, it is possible that fewer assets and liabilities arising from contingencies will be initially measured at fair value under Statement 141(R) than under revised IFRS 3.

B30. If the acquisition-date fair value of an asset or liability arising from a contingency cannot be determined during the measurement period, this FSP requires that the acquirer recognize an asset or liability if (a) information available before the issuance of the financial statements indicates that it is probable that an asset existed or that a liability had been incurred as of the acquisition date and (b) the amount of the asset or liability can be reasonably estimated. Revised IFRS 3 does not include a similar provision for the rare cases that fair value of a contingent liability cannot be measured reliably. Additionally, revised IFRS 3 does not allow for assets arising from contingencies in a business combination to be recognized at the acquisition date.

B31. Revised IFRS 3 requires an acquirer to subsequently measure a contingent liability at the higher of the amount that would be recognized under IAS 37 and the amount initially recognized less cumulative amortization recognized in accordance with IAS 18, if appropriate. This FSP eliminates the specific subsequent accounting guidance in Statement 141(R) for assets and liabilities arising from contingencies. Assets and liabilities arising from contingencies accounted for under Statement 141(R) are required to be subsequently measured and accounted for using a systematic and rational basis depending on their nature.

B32. Differences also exist between the disclosures required by Statement 141(R), as amended by this FSP, and revised IFRS 3. For an asset or liability arising from a contingency recognized at the acquisition date, this FSP requires that the acquirer disclose the amount recognized and the nature of the contingency. For contingencies that are not recognized at the acquisition date, this FSP requires that the acquirer include the disclosures required by Statement 5 in the footnote that describes the business combination. For contingencies in which there is at least a reasonable possibility that a loss will be incurred, Statement 5 requires that an entity disclose the nature of the contingency and give an estimate of the possible loss or range of loss or state that such an estimate cannot be made. Revised IFRS 3 carries forward the existing disclosure requirements in IAS 37 and requires an acquirer to disclose the reasons that the fair value of a contingent liability cannot be measured reliably, if applicable. For recognized contingencies, the acquirer is required to disclose (a) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits, (b) an indication of the uncertainties about the amount or timing of those outflows, including major assumptions made about future events, where necessary, to provide adequate information, and (c) the amount of any expected reimbursement and the amount of any asset that has been recognized for that expected reimbursement. For unrecognized contingencies, unless the possibility of any outflow in settlement is remote, the acquirer is required to disclose the nature of the contingency and, where practicable, (1) an estimate of its financial effect, (2) an indication of the uncertainties relating to the amount or timing of any outflow, and (3) the possibility of any reimbursement. Under IAS 37, entities also are required to disclose changes in the carrying amount of a contingent liability, including the reasons for those changes.