Notice for Recipients
of This Proposed FASB Staff Position

This proposed FASB Staff Position (FSP) would amend FASB Statement No. 141 (revised 2007), *Business Combinations,* to require that assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value, as determined in accordance with FASB Statement No. 157, *Fair Value Measurements,* if the acquisition-date fair value can be reasonably determined. It also would provide guidance for assessing when fair value can be reasonably determined. If the acquisition-date fair value of such an asset or liability cannot be reasonably determined, the asset or liability would be measured at the amount that would be recognized for liabilities in accordance with FASB Statement No. 5, *Accounting for Contingencies,* and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss,* and a similar amount for assets (hereafter referred to as "future settlement amount"). An asset or liability measured at its future settlement amount would only be recognized as of the acquisition date if (1) information available prior to the end of the measurement period indicates that it is probable that an asset existed or a liability had been incurred at the acquisition date and (2) the future settlement amount of the asset or liability can be reasonably estimated. This proposed FSP also would amend and clarify the subsequent measurement and accounting guidance and amend the disclosure requirements for assets and liabilities arising from contingencies in a business combination.

Effective Date and Transition

This proposed FSP would be 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.

Request for Comments

The Board invites individuals and organizations to send written comments on all matters in this proposed FSP, particularly on the questions listed below. Respondents need not comment on each issue and are encouraged to comment on additional matters they believe should be brought to the Board's attention. Comments are requested from those who agree with the provisions of this proposed FSP as well as from those who do not. Comments are most helpful if they identify the issues to which they relate and clearly explain the issue or question. Those who disagree with provisions of this proposed FSP are asked to describe their suggested alternatives, supported by specific reasoning.

The Board requests that constituents provide comments on the following questions:

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?
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)?
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?
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.

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?
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?
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?

Responses must be received in writing by January 15, 2009. Interested parties should submit their comments by email to director@fasb.org, File Reference: Proposed FSP FAS 141(R)-a. Those without email may send their comments to the "Technical Director-File Reference: Proposed FSP FAS 141(R)-a" at 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116. Responses should not be sent by fax.

All comments received by the FASB are considered public information. Those comments will be posted to the FASB website and included as part of the project record with other project materials.

Summary

Why Is the FASB Issuing This Proposed FSP and When Will It Be Effective?

This proposed FSP addresses application issues identified related to the accounting for assets and liabilities arising from contingencies in a business combination in accordance with FASB Statement No. 141 (revised 2007), *Business Combinations*. Concerns have been raised about (1) determining the acquisition-date fair value of liabilities arising from litigation-related contingencies, (2) supporting the recognition and measurement of liabilities arising from legal contingencies when supporting information may be prejudicial, (3) distinguishing between contractual and noncontractual contingencies, (4) applying the "more-likely-than-not" guidance to noncontractual contingencies, (5) applying the subsequent measurement and accounting guidance to assets and liabilities recognized at fair value, and (6) disclosing prejudicial information in the financial statements. To address those issues, this proposed FSP would amend certain provisions of Statement 141(R) related to initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination.

This proposed FSP would be 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.

How Will This Proposed FSP Change Current Practice?

This proposed FSP would modify the guidance in Statement 141(R) for accounting for assets and liabilities arising from contingencies in a business combination to make that guidance similar to the guidance in FASB Statement No. 141, *Business Combinations*. Statement 141 requires that an asset or liability arising from a contingency be recognized at fair value if fair value can be determined. This proposed FSP would require fair value recognition if fair value can be reasonably determined and would provide guidance for assessing when fair value can be reasonably determined. Because of the guidance included in this proposed FSP for assessing when fair value can be reasonably determined and because Statement 141 required that accruals for warranties be recognized at other than fair value, it is expected that more assets and liabilities arising from contingencies would be recognized at fair value under this proposed FSP than under current practice under Statement 141. However, it is likely that fewer assets and liabilities arising from contingencies would be recognized at fair value under this proposed FSP than would be recognized under the existing requirements of Statement 141(R). This proposed FSP also would clarify the subsequent measurement and accounting guidance and amend the disclosure requirements for assets and liabilities arising from contingencies in a business combination. Statement 141 does not currently have any subsequent measurement or disclosure requirements specific to assets and liabilities arising from contingencies.

What Is the Effect of This Proposed FSP on Existing Accounting Pronouncements?

This proposed FSP would amend the guidance in Statement 141(R) related to the accounting for assets and liabilities arising from contingencies in a business combination and certain related pronouncements that were amended by Statement 141(R).

How Will This Proposed FSP Improve Financial Reporting?

This proposed FSP would improve financial reporting by addressing concerns from preparers, auditors, and members of the legal profession about the application of 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. This proposed FSP would require that an asset or a liability arising from a contingency in a business combination be recognized at fair value if fair value can be reasonably determined. The Board believes that fair value is the most relevant measurement attribute for assets acquired and liabilities assumed in a business combination. However, the Board believes that there are certain circumstances in which the fair value of an asset or a liability arising from a contingency cannot be reasonably determined. This proposed FSP would provide guidance for assessing whether fair value can be reasonably determined. This proposed FSP also would amend and clarify the subsequent measurement and accounting guidance and amend the disclosure requirements for assets and liabilities arising from contingencies in a business combination.

What Is the Effect of This Proposed FSP on Convergence with International Financial Reporting Standards?

Revised International Financial Reporting Standard (IFRS) 3, *Business Combinations*, requires that a contingent liability assumed in a business combination be recognized at fair value if a present obligation that arises from past events exists and its fair value can be measured reliably. Under revised IFRS 3, assets arising from contingencies in a business combination are not recognized. This proposed FSP would require that an asset or a liability arising from a contingency be recognized at fair value if its fair value can be reasonably determined. In addition, if fair value of the asset or liability cannot be reasonably determined, this proposed FSP would require that an asset or a liability arising from a contingency be recognized at its estimated future settlement amount, if (1) information available prior to the end of the measurement period indicates that it is probable that an asset existed or a liability had been incurred at the acquisition date and (2) the future settlement amount of the asset or liability can be reasonably estimated. Under revised IFRS 3, if fair value of a liability arising from a contingency cannot be measured reliably, a liability is not recognized as of the acquisition date.

The requirement in the proposed FSP to subsequently measure a liability arising from a contingency initially recognized at fair value at the higher of its acquisition-date fair value (less any reductions for the acquirer's release from risk or performance of its obligation) and the amount that would be recognized if applying FASB Statement No. 5, *Accounting for Contingencies*, and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*, is similar to the requirement in revised IFRS 3 to subsequently measure a contingent liability at the higher of the amount that would be recognized under International Accounting Standard (IAS) 37, *Provisions, Contingent Liabilities and Contingent Assets*, and the amount initially recognized less cumulative amortization recognized in accordance with IAS 18, *Revenue*, if appropriate. However, differences in subsequent measurement will arise because of existing differences between IAS 37 and Statement 5. The International Accounting Standards Board is also in the process of completing a project to revise IAS 37, which may result in additional differences in the subsequent measurement of liabilities arising from contingencies. Additionally, the clarifying guidance included in the proposed FSP that allows an acquirer to derecognize a liability arising from a contingency when the acquirer obtains new information that indicates there is only a remote possibility that the obligation will be enforced is not included in revised IFRS 3.

PROPOSED FASB STAFF POSITION

No. FAS 141(R)-a

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

Comment Deadline: January 15, 2009

Objective

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

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. Statement 141(R) requires 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 are 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) requires that an asset or a liability arising from a contingency that is recognized as of the acquisition date continue to be reported at its acquisition-date fair value. When

new information is obtained, a liability shall be measured at the higher of its acquisition-date fair value or the amount that would be recognized if applying Statement 5. An asset shall be measured at the lower of its acquisition-date fair value or the best estimate of its future settlement amount. An asset or liability arising from a preacquisition contingency shall 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 have expressed concerns about the application of Statement 141(R) to assets and liabilities arising from contingencies in a business combination. Application issues include:

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 prejudicial
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 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
e. Derecognizing a liability arising from a contingency recognized as of the acquisition date
f. Disclosing potentially prejudicial information in financial statements.

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, including an acquiree's contingent consideration arrangement assumed by the acquirer in a business combination.

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, as of 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 reasonably determined during the measurement period.**

8. If the acquisition-date fair value of an asset acquired or liability assumed in a business combination that arises from a contingency can be reasonably determined, the framework for measuring fair value provided in FASB Statement No. 157, *Fair Value Measurements,* should be applied.

9. 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. If the fair value of the asset or liability arising from a

contingency cannot be estimated based on an observable market price, the fair value of the asset or liability may be reasonably determinable if sufficient information exists to apply a valuation technique.

10. The valuation technique that often will be applied to assets and liabilities arising from contingencies is an income approach. An income approach incorporates uncertainty about the timing and amount of future cash flows into the fair value measurement. However, in some cases, sufficient information about the timing and/or amount of future cash flows may not be available to reasonably estimate the fair value of an asset or liability arising from a contingency. An acquirer would have sufficient information to apply an income approach, and therefore the fair value of an asset or a liability arising from a contingency would be reasonably determinable, if information is available to reasonably estimate (a) the date the contingency will be resolved or a range of potential resolution dates, (b) the amount of future cash flows or a range of potential future cash flows, and (c) the probabilities associated with the potential resolution dates and potential future cash flows.

11. The acquirer should have a reasonable basis for assigning probabilities to the potential resolution dates and potential future cash flows to reasonably determine the fair value of the asset or liability. If the acquirer does not have a reasonable basis for assigning probabilities, the acquirer should still be able to reasonably determine the fair value when the potential timing and amount of future cash flows are so narrowly distributed that assigning probabilities without having a reasonable basis for doing so would not materially affect the fair value of the asset or liability.

12. In many cases, determining whether the acquirer has the information available to reasonably determine the fair value of the asset or liability arising from a contingency is a matter of judgment that depends on the relevant facts and circumstances. Usually, the shorter the time period until the acquirer expects to settle or resolve the contingency, the more likely it is that the acquirer will have the information available to reasonably determine the fair value of the asset or liability.

13. Because of the number of variables and assumptions involved in assessing the possible outcomes of a legal dispute, sufficient information may not exist to reasonably estimate the date the contingency will be resolved or a range of potential resolution dates or the probabilities associated with a range of potential settlement amounts related to a legal dispute, particularly in the early stages of the case. Therefore, entities often will not be able to reasonably determine the acquisition-date fair value of a liability arising from a legal contingency, particularly in its early stages. However, it is expected that sufficient information will be available to measure the acquisition-date fair value of other assets and liabilities arising from contingencies in a business combination, including some legal contingencies in the later stages of the case.

14. **If the acquisition-date fair value of an asset acquired or a liability assumed in a business combination that arises from a contingency cannot be reasonably determined during the measurement period, the acquirer shall measure that asset or liability at the amount that would be recognized for liabilities in accordance with Statement 5 and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss,* and a similar amount for assets (hereafter referred to as "future settlement amount"). An asset or liability measured at its future settlement amount shall only be recognized as of the acquisition date if information available prior to the end of the measurement period indicates that it is probable that an asset existed or a liability had been incurred at the acquisition date and if the future settlement amount of the asset or liability can be reasonably estimated.** It is implicit in these conditions that it must be probable at the acquisition date that one or more future events will occur confirming the existence of the asset or liability.

15. In applying the criteria in paragraph 14, the acquirer shall estimate the future settlement amount using information that is available during the measurement period about facts and circumstances that existed as of the acquisition date.

16. If the recognition criteria in paragraph 7 or 14 above are not 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. The acquirer instead 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 GAAP, including Statement 5, as appropriate.

17. Examples 1 and 2 below provide illustrative guidance for understanding and applying paragraphs 24–24D of Statement 141(R), as amended by the provisions of this FSP. The examples and related assumptions are illustrative only; the examples are not all-inclusive and may not represent actual situations.

Example 1

In December 20X8, a former employee filed suit against TC claiming damages of $1 million for alleged violation of age discrimination laws. On June 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 under way but were not yet complete. TC's management asserts that its hiring and promotion practices complied with all applicable laws and regulations. An active market does not exist to transfer the potential liability arising from the lawsuit or a similar liability to a third party.

AC does not believe sufficient information currently exists to reasonably estimate the timing or manner in which the liability will be resolved (that is, it cannot determine a resolution date or range of potential resolution dates or the probabilities associated with a range of potential settlement amounts), particularly because the lawsuit is in the early stages. Therefore, AC would conclude that the fair value of the potential liability arising from the lawsuit cannot be reasonably determined at the acquisition date. AC would then be required to make a judgment as to whether it is probable that a liability had been incurred as of the acquisition date. If it is probable that a liability had been incurred and the amount of loss can be reasonably estimated, a liability would be recognized at the acquisition date by applying the guidance in Statement 5 and Interpretation 14. If it is probable that a liability had been incurred but the amount of loss cannot be reasonably estimated, AC would not recognize a liability at the acquisition date but would apply the disclosure requirements of Statement 5.

Example 2
On June 30, 20X4, AC purchases all of TC's outstanding equity shares for cash. TC's products include a standard three-year warranty. An active market does not exist for the transfer of the warranty obligation or similar warranty obligations. AC expects that the majority of the warranty expenditures associated with products sold in the last three years will be incurred in 20X4 and 20X5 and that all will be incurred by the end of 20X6. 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. AC is able to estimate the probabilities associated with the potential claims under the warranty arrangements based on TC's historical experience with the products in question and AC's own experience for similar products.

AC would conclude that the fair value of the liability arising from the warranty obligation can be reasonably determined at the acquisition date because the range of potential resolution dates, range of potential future cash flows, and probabilities associated with the potential resolution dates and potential future cash flows can be reasonably estimated. AC would recognize the fair value of the liability at the acquisition date by applying the measurement framework in Statement 157.

Subsequent Measurement and Accounting

Liabilities Arising from Contingencies Recognized at Fair Value

18. **The subsequent accounting for a liability arising from a contingency recognized at fair value as of the acquisition date shall be based on whether an acquirer is released from risk over time or fulfills its performance obligation over time.**

19. **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. If the acquirer obtains new information about the possible outcome of the contingency, the acquirer shall evaluate that information and measure the liability at the higher of its carrying amount (that is, the acquisition-date fair value less any reductions for the acquirer's release from risk or performance of its obligation) and the amount that would be recognized if applying Statement 5 and Interpretation 14.**

20. **If the acquirer neither is released from risk over time nor fulfills its performance obligation over time, the acquirer shall continue to report the liability**

arising from a contingency at its acquisition-date fair value until (a) new information about the possible outcome of the contingency is obtained that indicates that it has become remote that the obligation will be enforced (that is, performance will not be required), (b) the acquirer settles the liability, or (c) its obligation to settle it is cancelled or expires. If any of those conditions are met, the acquirer shall derecognize the liability. If the acquirer obtains new information about the possible outcome of the contingency that indicates that the amount that would be recognized if applying Statement 5 and Interpretation 14 is higher than the acquisition-date fair value, the acquirer shall adjust the liability to the amount that would be recognized if applying Statement 5 and Interpretation 14.

21. If a liability is subsequently measured at the amount that would be recognized if applying Statement 5 and Interpretation 14, the acquirer shall continue to measure the liability in accordance with Statement 5 and Interpretation 14.

Liabilities Arising from Contingencies Recognized at Estimated Future Settlement Amount

22. **A liability arising from a contingency initially recognized at an amount other than fair value as of the acquisition date shall be subsequently accounted for in accordance with Statement 5 and Interpretation 14.**

Assets Arising from Contingencies Recognized at Fair Value

23. **An asset arising from a contingency recognized at fair value as of the acquisition date shall be subsequently measured at the lower of its acquisition-date fair value and its estimated future settlement amount when new information is obtained about the possible outcome of the contingency.**

Assets Arising from Contingencies Recognized at Estimated Future Settlement Amount

24. **An asset arising from a contingency recognized at an amount other than fair value as of the acquisition date shall be subsequently measured at the lower of the amount recognized at the acquisition date and the estimated future settlement amount when new information is obtained about the possible outcome of the contingency.**

Disclosures

25. **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. An acquirer also shall disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognized in the current reporting period that relate to business combinations that occurred in the current or previous reporting periods.**

26. For each business combination that occurs during the reporting period for assets and liabilities arising from contingencies recognized at the acquisition date an acquirer shall disclose the following:

a. The amounts recognized at the acquisition date
b. The nature of the contingencies
c. An estimate of the range of outcomes (undiscounted)
d. If the asset or liability was not recognized at fair value, the reasons why the fair value of the asset or liability cannot be reasonably determined.

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

27. For each reporting period after the acquisition date until the asset or liability arising from a contingency is derecognized in full an acquirer shall disclose the following:

a. 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. An acquirer is not required to disclose this information for an unrecognized contingency if it is not at least reasonably possible that a liability has been incurred. An acquirer also is not required to disclose this information for an unrecognized contingency involving an unasserted claim or assessment if a potential claimant has not indicated an awareness of a possible claim or assessment. However, if the acquirer determines that it is probable that a claim will be asserted and it is reasonably possible that the outcome would be unfavorable, disclosure is required.
b. For liabilities recognized at fair value at the acquisition date, if there has been a change in the measurement of the liability during the reporting period from the acquisition-date fair value to the amount that would be recognized if applying Statement 5 and Interpretation 14, the amount of the change and the reason for the change.

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

Effective Date and Transition

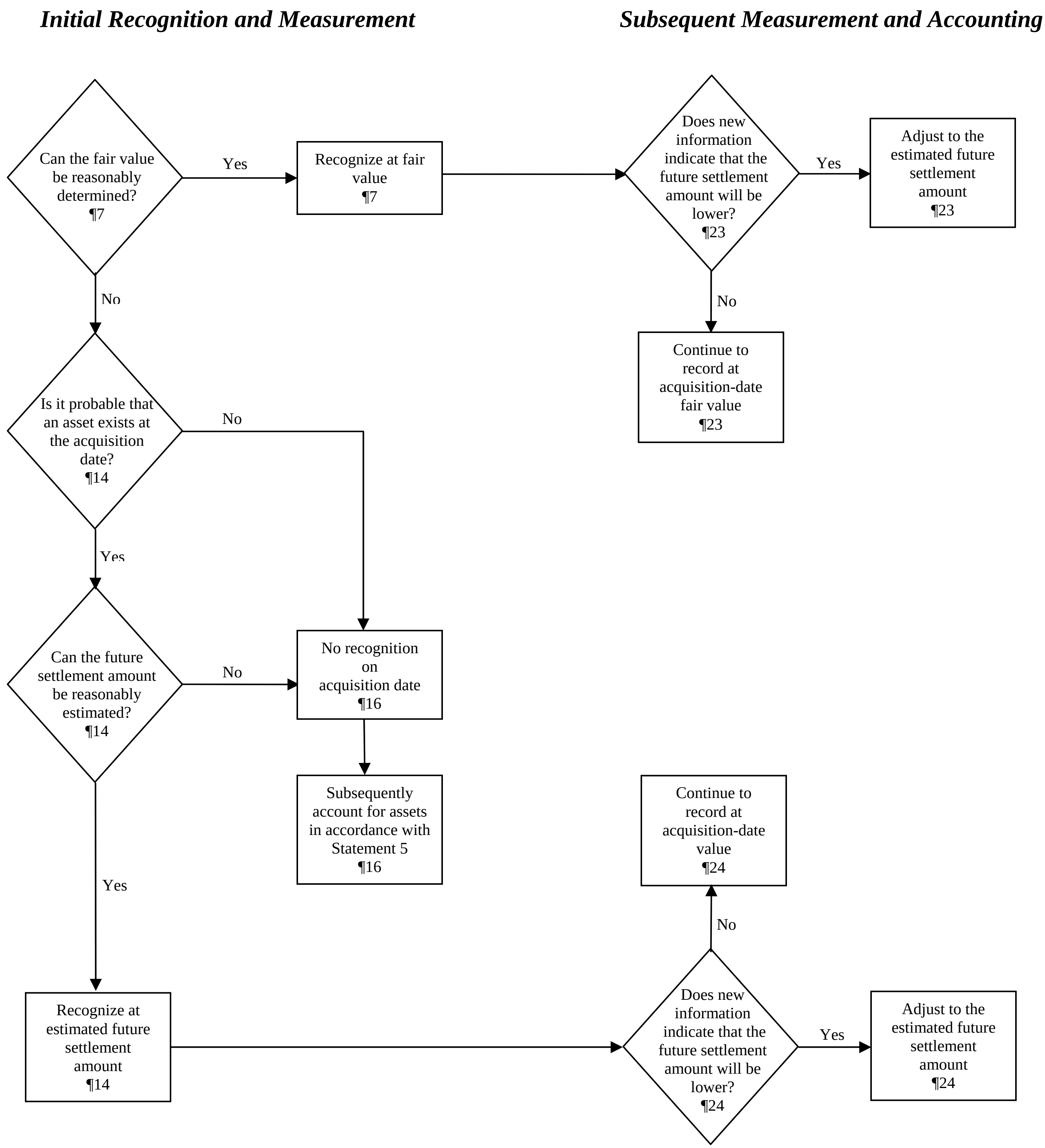
28. **This FSP shall be effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008.**

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

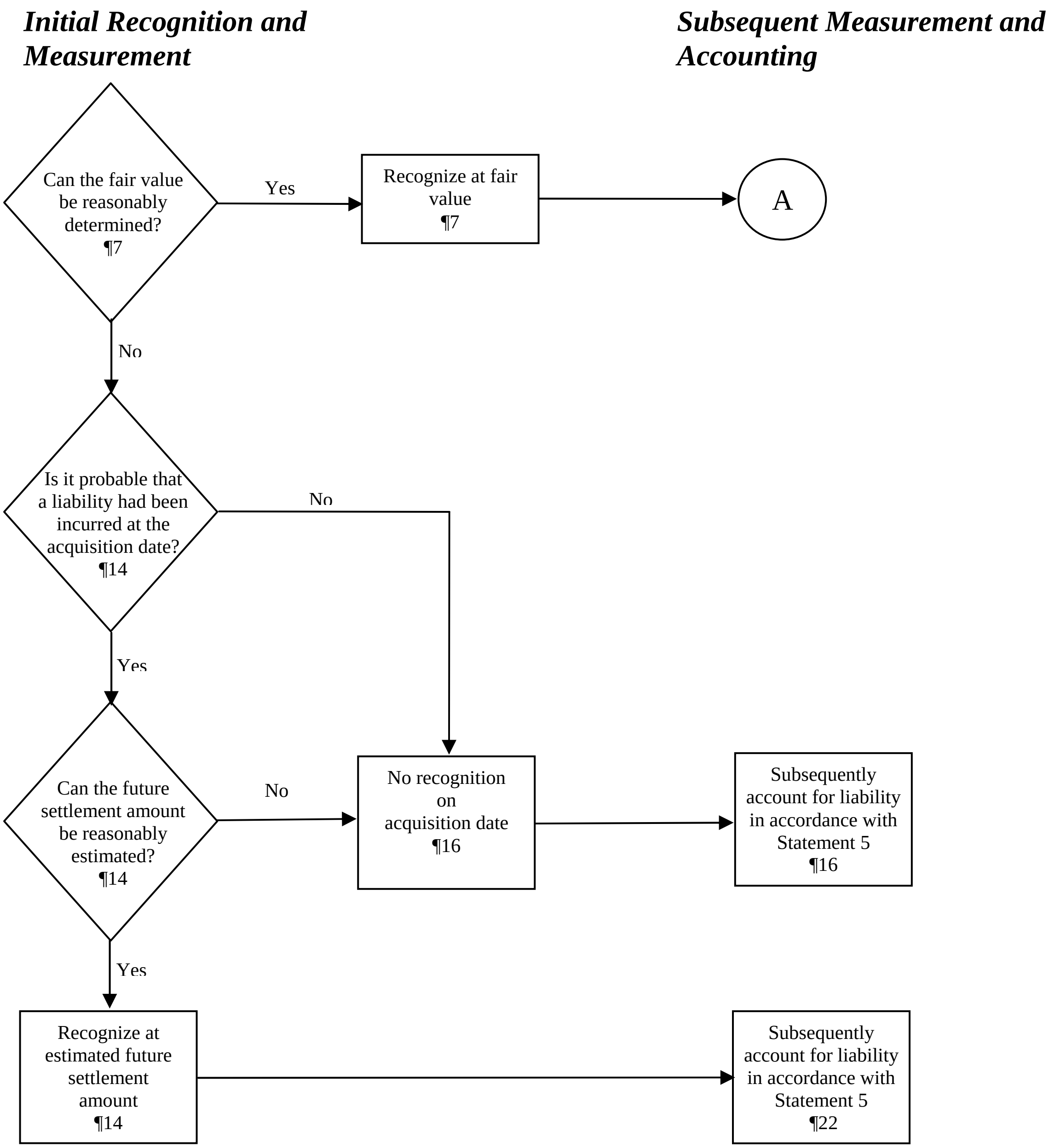
Appendix A–Decision Trees

[Note: All paragraph references are to the related paragraphs in this FSP.]

Assets Arising from Contingencies in a Business Combination

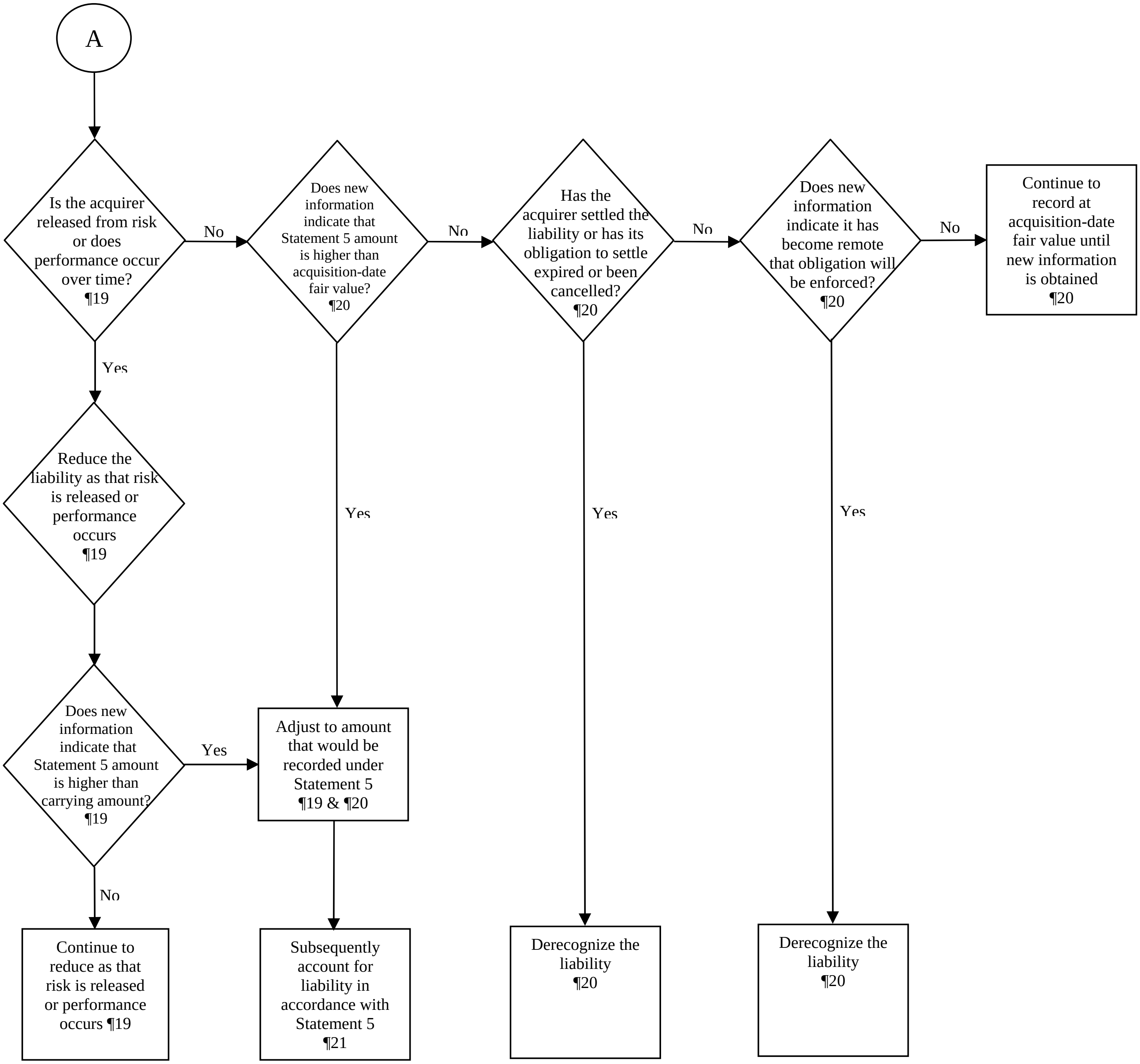


Liabilities Arising from Contingencies in a Business Combination



Liabilities Arising from Contingencies in a Business Combination

Subsequent Measurement and Accounting



Appendix B

Amendments

B1. Statement 141(R) is amended as follows: [Added text is underlined and deleted text is ~~struck out~~.]

a. The heading before paragraph 23 is amended as follows:

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 assets acquired and liabilities assumed that arise from contingencies that would be within the scope of Statement 5 if not acquired or assumed in a business combination as of the acquisition date as follows:

a. If the acquisition-date fair value of the asset or liability arising from a contingency can be reasonably determined during the measurement period, that asset or liability shall be recognized as of the acquisition date based on that fair value.

b. If the acquisition-date fair value of the asset or liability arising from a contingency cannot be reasonably determined during the measurement period, that asset or liability shall be recognized as of the acquisition date at the amount that would be recognized for liabilities in accordance with Statement 5 and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*, and a similar amount for assets (hereafter referred to as "future settlement amount") if:

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

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

The criteria in this subparagraph shall be applied using information that is available during the measurement period about facts and circumstances that existed as of the acquisition date.

If the above recognition criteria are not met at the acquisition date based on 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. The acquirer shall instead 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 GAAP, including Statement 5, as appropriate.

c. Paragraphs 24A–24D are added as follows:

24A. If the acquisition-date fair value of an asset acquired or liability assumed in a business combination that arises from a contingency can be reasonably determined, the framework for measuring fair value provided in Statement 157 shall be applied. The fair value of an asset or a liability arising from a contingency is reasonably determinable if a price for the asset or liability or an essentially similar asset or liability can be observed in the marketplace. If the fair value of the asset or liability arising from a contingency cannot be estimated based on an observable market price, the fair value of the asset or liability also may be reasonably determinable if sufficient information exists to apply a valuation technique.

24B. The valuation technique that often will be applied to assets and liabilities arising from contingencies is an income approach. An income approach incorporates uncertainty about the timing and amount of future cash flows into the fair value measurement. However, in some cases, sufficient information about the timing and/or amount of future cash flows may not be available to reasonably determine fair value. An acquirer would have sufficient information to apply an income approach, and therefore the fair value of an asset or a liability arising from a contingency would be reasonably determinable, if the information is available to reasonably estimate (a) the date the contingency will be resolved or a range of potential resolution dates, (b) the amount of future cash flows or a range of potential future cash flows, and (c) the probabilities associated with the potential resolution dates and potential cash flows. Paragraphs A64–A65A provide illustrative guidance for understanding and applying this paragraph.

24C. The acquirer should have a reasonable basis for assigning probabilities to the potential resolution dates and potential future cash flows to reasonably estimate the fair value of the asset or liability. If the acquirer does not have a reasonable basis for assigning probabilities, the acquirer should still be able to reasonably determine fair value when the potential timing and amount of future cash flows are so narrowly distributed that assigning probabilities without having a reasonable basis for doing so would not materially affect the fair value of the asset or liability.

24D. In many cases, determining whether the acquirer has the information to reasonably determine the fair value of the asset or liability arising from a contingency is a matter of judgment that depends on the relevant facts and circumstances. Usually, the shorter the time period until the acquirer expects to settle or resolve the contingency, the more likely it is that the acquirer will have the information to reasonably determine the fair value of the asset or liability.

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~~62E 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~~ are recognized as of the acquisition date.

~~***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~~ criteria for recognition in paragraph 24 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 62:

The subsequent accounting for ~~an asset or~~ a liability arising from a contingency recognized at fair value 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 shall be based on whether the acquirer is released from risk over time or fulfills its performance obligation over time ~~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.~~

g. Paragraphs 62A–62E are added as follows:

62A. If the acquirer is released from risk over time or fulfills its performance obligation over time, the liability shall be reduced as that risk is released or performance occurs. If the acquirer obtains new information about the possible outcome of the contingency, the acquirer shall evaluate that information and measure the liability at the higher of its carrying amount (that is, the acquisition-date fair value less any reductions for the acquirer's release from risk or performance of its obligation) and the amount that would be recognized if applying Statement 5 and Interpretation 14.

62B. If the acquirer neither is released from risk over time nor fulfills its performance obligation over time, the acquirer shall continue to report the liability arising from a contingency at its acquisition-date fair value until (a) new information about the possible outcome of the contingency is obtained that indicates that it has become remote that the obligation will be enforced (that is, performance will not be required), (b) the acquirer settles the liability, or (c) its obligation to settle it is cancelled or expires. If any of those conditions are met, the acquirer shall derecognize the liability. If the acquirer obtains new information about the possible outcome of the contingency that indicates that the amount that would be recognized if applying Statement 5 and Interpretation 14 is higher than the acquisition-date fair value, the acquirer shall adjust the liability to the amount that would be recognized if applying Statement 5 and Interpretation 14.

62C. If a liability that was recognized at fair value as of the acquisition date is subsequently measured at the amount that would be recognized if applying Statement 5 and Interpretation 14, the acquirer shall continue to measure the liability in accordance with Statement 5 and Interpretation 14.

62D. A liability arising from a contingency recognized at an amount other than fair value as of the acquisition date shall be subsequently accounted for in accordance with Statement 5 and Interpretation 14.

62E. An asset arising from a contingency recognized at fair value as of the acquisition date shall be subsequently measured at the lower of its acquisition-date fair value and the best estimate of its future settlement amount when new information is obtained about the possible outcome of the contingency. An asset arising from a contingency recognized at an amount other than fair value as of the acquisition date shall be subsequently measured at the lower of the amount recognized at the acquisition date and the best estimate of its future settlement amount when new information is obtained about the possible outcome of the contingency.

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 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)~~
(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.~~
(4) If the asset or liability was not recognized at fair value, the reasons why the fair value of the asset or liability cannot be reasonably determined.

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

j. 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~~ asset or liability arising from a contingency is derecognized in full:

(1) ~~Any changes in the recognized amounts of assets and liabilities arising from contingencies and the reasons for those changes~~ 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. An acquirer is not required to disclose this information for an unrecognized contingency if it is not at least reasonably possible that an asset exists or a liability has been incurred. An acquirer also is not required to disclose this information for an unrecognized contingency

involving an unasserted claim or assessment if a potential claimant has not indicated an awareness of a possible claim or assessment. However, if the acquirer determines that it is probable that a claim will be asserted and it is reasonably possible that the outcome would be unfavorable, disclosure is required

(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~~ For liabilities recognized at fair value at the acquisition date, if there has been a change in the measurement of the liability during the reporting period from the acquisition-date fair value to the amount that would be recognized if applying Statement 5, the amount of the change, and the reason for the change.

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

k. Paragraph A62:

Paragraph 24 requires that if the acquisition-date fair value of the asset or liability arising from a contingency can be reasonably determined during the measurement period, that asset or liability shall be recognized as of the acquisition date based on that fair value. Paragraphs 24A–24D provide guidance for assessing whether the acquisition date fair value of the asset or liability arising from a contingency can be reasonably determined. ~~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.~~

l. 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.~~
It is expected that because of the number of variables and assumptions involved in assessing the possible outcomes of a legal dispute, sufficient information may not exist to reasonably estimate the resolution date or range of potential resolution dates or the probabilities associated with a range of potential settlement amounts related to a legal dispute, particularly in the early stages of the case. Therefore, entities often will not be able to reasonably determine the acquisition-date fair value of a liability arising from a legal contingency, particularly in its early stage. However, sufficient information will be available to measure the acquisition-date fair value of other assets and liabilities arising from contingencies in a business combination, including some legal contingencies in the later stages of the case. Examples 1 and 2 below provide illustrative guidance for understanding and applying paragraphs 24–24D. The examples and related assumptions are illustrative only; the examples are not all-inclusive and may not represent actual situations.

m. Paragraph A64:

Example 1~~: A Liability Arising from a Noncontractual Contingency~~
In December 20X8, a former employee filed suit against TC claiming damages of $1 million for alleged ~~alleging~~ violation of age discrimination laws. On June 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 under_way but were not yet complete. TC's management asserts that its hiring and promotion practices complied with all applicable laws and regulations. An active market does not exist to transfer the potential liability arising from the lawsuit or a similar liability to a third party.

n. Paragraph A64A is added as follows:

AC does not believe sufficient information currently exists to reasonably estimate the timing or manner in which the liability will be resolved (that is, it cannot determine a resolution date or range of potential resolution dates or the probabilities associated with a range of potential settlement amounts), particularly because the lawsuit is in the early stages. Therefore, AC would conclude that the fair value of the potential liability arising from the lawsuit cannot be reasonably determined at the acquisition date. AC would then be required to make a judgment as to whether it is probable that a liability had been incurred as of the acquisition date. If it is probable that a liability had been incurred and the amount of loss can be reasonably estimated, a liability would be recognized at the acquisition date by applying the guidance in Statement 5 and Interpretation 14. If it is probable that a liability had been incurred but the amount of loss cannot be reasonably estimated, AC would not recognize a liability at the acquisition date but would apply the disclosure requirements of Statement 5.

o. 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.~~

Example 2

On June 30, 20X4, AC purchases all of TC's outstanding equity shares for cash. TC's products include a standard three-year warranty. An active market does not exist for the transfer of the warranty obligation or similar warranty obligations. AC expects that the majority of the warranty expenditures associated with products sold in the last three years will be incurred in 20X4 and 20X5 and that all will be incurred by the end of 20X6. 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. AC is able to estimate the probabilities associated with the potential claims under the warranty arrangements based on TC's historical experience with the products in question and AC's own experience for similar products.

p. Paragraph A65A is added as follows:

AC would conclude that the fair value of the liability arising from the warranty obligation can be reasonably determined at the acquisition date because the range of potential resolution dates, range of potential future cash flows, and probabilities associated with the potential resolution dates and potential future cash flows can be reasonably estimated. AC would recognize the fair value of the liability at the acquisition date by applying the measurement framework in Statement 157.

q. Appendix G, the guidance titled, "Assets and liabilities arising from contingencies:"

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~~ if their acquisition-date fair values can be reasonably 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 reasonably determined during the measurement period, the acquirer shall recognize that asset or liability at its estimated future settlement amount as of the acquisition date if (1) information available prior to the end of the measurement period indicates that it is probable that an asset existed or a liability had been incurred at the acquisition date and (2) the future settlement amount of the asset or liability can be reasonably estimated. ~~Noncontractual~~ ~~c~~Contingencies that do not meet the recognition ~~threshold~~criteria as of the acquisition date are accounted for in accordance with other GAAP, including FASB Statement No. 5, *Accounting for Contingencies*, as appropriate. [paragraphs 23–25]

Subsequent Measurement

Statement 141(R) requires that an acquirer continue to report ~~an asset or~~a liability arising from a~~ contractual or noncontractual~~ contingency that is recognized at fair value as of the acquisition date based on whether the acquirer is released from risk over time or fulfills its performance obligation over time. ~~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~~
- ~~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.~~

If the acquirer is released from risk over time or fulfills its performance obligation over time, the liability would be reduced as that risk is released or performance occurs. If the acquirer obtains new information about the possible outcome of the contingency, the acquirer would evaluate that information and measure the liability at the higher of its carrying amount and the amount that would be recognized if applying Statement 5 and Interpretation 14.

If the acquirer is not released from risk over time and does not fulfill its performance obligation over time, the acquirer would continue to report the liability arising from a contingency at its acquisition-date fair value until (a) new information about the possible outcome of the contingency is obtained that indicates that it has become remote that the obligation will be enforced (that is, performance will not be required), (b) the acquirer settles the liability, or (c) its obligation to settle it is cancelled or expires. If any of those conditions are met, the acquirer shall derecognize the liability. If the acquirer obtains new information about the possible outcome of the contingency that indicates that the amount that would be recognized if applying Statement 5 and Interpretation 14 is higher than the acquisition-date fair value, the acquirer would adjust the liability to the amount that would be recognized if applying Statement 5 and Interpretation 14.

If a liability that was recognized at fair value at the acquisition date is subsequently measured at the amount that would be recognized if applying Statement 5 and Interpretation 14, the acquirer shall continue to measure the liability in accordance with Statement 5 and Interpretation 14.

A liability arising from a contingency recognized at an amount other than fair value as of the acquisitions shall be subsequently accounted for in accordance with Statement 5 and Interpretation 14.

An asset arising from a contingency recognized at fair value as of the acquisition date shall be subsequently measured at the lower of its acquisition-date fair value and the best estimate of its future settlement amount when new information is obtained about the possible outcome of the contingency. An asset arising from a contingency recognized at an amount other than fair value as of the acquisition date shall be subsequently measured at the lower of the amount recognized at the acquisition date and the best estimate of its future settlement amount when new information is obtained about the possible outcome of the contingency.

[paragraphs 62~~–and 63~~62E]

Disclosures

Statement 141(R)’s 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 72(c); the revised IFRS 3, paragraphs B64(j) and B67(c)]

Implementation Guidance

Statement 141(R) provides implementation guidance for ~~applying the more-likely-than-not criterion for recognizing noncontractual contingencies~~ assessing whether the acquisition date fair value of an asset or liability arising from a contingency can be reasonably determined. The revised IFRS 3 does not have equivalent guidance. [Statement 141(R), paragraphs A62–A65A]

B2. FASB Statement No. 5, *Accounting for Contingencies,* is amended as follows:

a. Paragraph 7A:

This Statement does not apply to contingent gains or losses that are recognized at fair value or to contingent gains 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 and disclosure requirements for contingent gains or losses recognized at fair value and for contingent gains 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 and contingent losses that are recognized at an amount other than fair value on the acquisition date. This Statement also applies to contingent losses in a business combination that are initially recognized at fair value at the acquisition date when new information is obtained about the possible outcome of the contingency and the amount that would be recognized under this Statement is higher than the acquisition-date fair value.

B3. FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*, is amended as follows:

a. Paragraph 59D:

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 C

BASIS FOR CONCLUSIONS AND ALTERNATIVE VIEW

Introduction

C1. This appendix summarizes considerations that Board members deemed significant in reaching the conclusions in this proposed 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

C2. The 2005 Exposure Draft for Statement 141(R) 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 that to faithfully represent the acquirer's economic circumstances resulting from the business combination at the acquisition date, in principle, all identifiable assets acquired and liabilities assumed should be recognized separately from goodwill, including assets and liabilities arising from contingencies at the acquisition date.

C3. Respondents to the 2005 Exposure Draft expressed concerns about how to deal with uncertainty about whether and when a contingency gives rise to an asset or a liability that meets the definition in Concepts Statement 6, 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 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 Statement 141.

C4. 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 their auditors deal with element uncertainty, the Board decided to add a requirement 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 is 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 is not met at the acquisition date, the acquirer shall not recognize an asset or a liability at that date. Instead, the acquirer shall 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.

C5. The Board concluded that sufficient information is 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.

C6. After the issuance of Statement 141(R), preparers, auditors, and members of the legal profession raised a number of application issues regarding the requirements in Statement 141(R) related to assets and liabilities arising from contingencies. In particular, preparers and members of the legal profession were concerned about providing auditors with evidence to support the recognition and measurement of liabilities related to certain loss contingencies assumed in a business combination under Statement 141(R) because such information could be prejudicial.

C7. Preparers and attorneys were concerned that information provided to an independent auditor about whether it is more likely than not that a liability exists under Concepts Statement 6 could lose its privileged status and could be subject to discovery. Attorneys indicated that if an acquirer recognizes a liability for a contingency because it has concluded that it is more likely than not that a liability exists under Concepts Statement 6, the acquirer could be perceived as admitting guilt (even though the law may be highly uncertain in the relevant area). The result could be prejudicial to the acquirer. The American Bar Association's *Statement of Policy Regarding Lawyer's Responses to Auditors' Requests for Information (Statement of Policy)* 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 serving their clients' interests under the adversarial legal system that exists in the United States and providing auditors with audit evidence that states that their client is more likely than not liable in a given case.

C8. 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 lawyers are much more likely to develop significantly different assessments of the fair value of a legal contingency than individual valuation experts determining the fair value of other assets and liabilities that involve unobservable inputs (for example, an identifiable intangible asset).

C9. In addition to raising concerns about litigation-related contingencies, preparers and auditors have 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 but 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.

C10. The Board decided to adopt a model similar to the guidance currently in Statement 141 to temporarily address the application issues raised by constituents until the Board determines whether to separately address the accounting for all contingencies by reconsidering Statement 5 or by participating in the IASB's project to revise IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*. Statement 141 requires that an asset or liability arising from a contingency be recognized at fair value if the fair value can be determined.

C11. 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 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. To develop that guidance, the Board decided to use as a starting point the guidance included in FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations*, for assessing whether the fair value of a conditional asset retirement obligation can be reasonably estimated because Interpretation 47 addresses situations in which sufficient information may not be available to make a reasonable estimate of fair value.

C12. The Board concluded that the fair value of an asset or a liability arising from a contingency would be reasonably determinable if a price for the asset or liability or an essentially similar asset or liability can be observed in the marketplace. If the fair value of the asset or liability arising from a contingency cannot be estimated based on an observable market price, the fair value of the asset or liability also may be reasonably determinable if sufficient information exists to apply a valuation technique. The valuation technique that often would be applied to assets and liabilities arising from contingencies is an income approach. An acquirer would have sufficient information to apply an income approach if the information is available to reasonably estimate (a) the resolution date or the range of potential resolution dates, (b) the amount of future cash flows or range of potential future cash flows, and (c) the probabilities associated with the potential resolution dates and potential future cash flows.

C13. The Board believes that because of the number of variables and assumptions involved in assessing the possible outcomes of a legal dispute, the fair value of a liability arising from a legal contingency may not be reasonably determinable, particularly in the early stages of the case. However, the Board believes that sufficient information is likely to be available to measure the acquisition-date fair value of many assets and liabilities arising from contingencies in a business combination, including some legal contingencies in the later stages of the case.

Subsequent Measurement and Accounting

Assets and Liabilities Arising from Contingencies Recognized at Fair Value

C14. The Board decided to adopt a model similar to the guidance currently in Statement 141 for the initial recognition and measurement of assets and liabilities arising from contingencies in a business combination. However, Statement 141 did not provide subsequent measurement and accounting guidance for assets and liabilities recognized as of the acquisition date. The Board observed that if Statement 5 is applied in the postcombination period to assets and liabilities arising from contingencies recognized at fair value at the acquisition date, the acquirer could recognize an immediate gain or loss in the postcombination period because of differences between the recognition and measurement requirements of Statement 141(R) and Statement 5. Therefore, the Board decided that it should address the subsequent measurement and accounting for assets and liabilities arising from contingencies recognized at fair value at the acquisition date.

C15. The 2005 Exposure Draft for Statement 141(R) proposed that assets and liabilities arising from contingencies recognized at the acquisition date 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 assets and liabilities arising from contingencies acquired in a business combination than of other similar assets and liabilities not acquired in a business combination; that would make financial reports more difficult to understand. As a practical alternative, the Board decided 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 is 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:
    (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:
    (1) Its acquisition-date fair value; or
    (2) The best estimate of its future settlement amount.

C16. 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.

C17. The Board also concluded 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.

C18. 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 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. These constituents were concerned that Statement 141(R) does 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.

C19. 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 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. The Board observed that the guidance in revised IFRS related to contingent liabilities appears to address this issue. 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 and (b) the amount initially recognized less, if appropriate, cumulative amortization recognized in accordance with IAS 18, *Revenue*. For example, in the case of a guarantee, the liability would be amortized over the service period unless the amount that would be recognized in accordance with IAS 37 was higher (for example, if it became likely that the acquirer would have to make a payment under the guarantee). The Board decided to include clarifying language in Statement 141(R) to allow an acquirer to reflect its release from risk or performance under the obligation over time.

C20. 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 will not be required). This change addresses 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.

C21. Because Statement 141(R) requires that an asset be measured at the lower of its acquisition-date fair value and the best estimate of its future settlement amount, the Board concluded that concerns raised about the subsequent accounting and measurement guidance in Statement 141(R) for liabilities do not apply to assets arising from contingencies recognized at fair value. Therefore, this FSP does not make any changes to the subsequent measurement and accounting guidance in Statement 141(R) for assets arising from contingencies recognized at fair value.

Assets and Liabilities Arising from Contingencies Recognized at an Amount Other than Fair Value

C22. The Board concluded that liabilities arising from contingencies that are recognized at an amount other than fair value at the acquisition date should be recognized in accordance with Statement 5, which is consistent with current practice. The Board concluded that assets arising from contingencies that are recognized at an amount other than fair value at the acquisition date should be recognized at the lower of the acquisition-date value and the estimated future settlement amount. The Board believes that this measure for assets is similar to the measure required by Statement 5 for liabilities. The Board also observed that the approach for assets allows for the recognition of impairments to the asset.

Disclosures

C23. After the issuance of Statement 141(R), constituents raised concerns about the disclosure requirements in Statement 141(R) 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 counterparty 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 it requires entities to disclose unasserted claims or assessments even when the chances of a claim being asserted are less than probable; such disclosure is inconsistent with Statement 5 and the *Statement of Policy* between auditors and attorneys.

C24. The Board believes the disclosures provided in practice in accordance with Statement 5 are not adequate and 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. The Board believes Statement 5 would require disclosure of the amount accrued if that amount is material, which is what is required by Statement 141(R). 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.

C25. Because this proposed FSP would require assets and liabilities arising from contingencies to be recognized at fair value if fair value can be reasonably determined, the Board decided to require disclosure of the reasons why the fair value of an asset or a liability cannot be reasonably determined. The Board also concluded that when there has been a change in the measurement of a liability during the reporting period from the acquisition-date fair value to the amount that would be recognized if applying Statement 5 and Interpretation 14, an acquirer must disclose the amount of and reason for the change.

Benefits and Costs

C26. 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 before it is issued.

C27. It is likely that fewer assets and liabilities arising from contingencies would be separately recognized and initially measured at fair value under this proposed FSP than would have been recognized had Statement 141(R) not been amended. Therefore, it is expected that the costs of implementing the final FSP would be less than the costs of implementing the original requirements in Statement 141(R) prior to this amendment. However, the Board believes that more assets and liabilities arising from contingencies will be separately recognized and initially measured at fair value under this proposed FSP than have historically been recognized under Statement 141 because of (1) the guidance in this FSP for assessing when fair value can be reasonably determined and (2) the Statement 141 requirement that accruals for warranties be recognized at other than fair value. Therefore, the Board acknowledges that there will be costs associated with applying the initial and subsequent measurement provisions of this FSP.

C28. Because this proposed FSP requires that assets and liabilities arising from contingencies be recognized at fair value if fair value can be reasonably determined, the Board believes this guidance will continue to provide benefits to investors, creditors, and other users of financial statements, while addressing operational issues raised by various constituents that could have resulted in significant costs to preparers.

International Financial Reporting Standards

C29. This proposed FSP eliminates some of the differences between revised IFRS 3 and Statement 141(R) in the accounting for assets and liabilities arising from contingencies in a business combination. This proposed FSP eliminates the distinction between a contractual and noncontractual contingency and the more-likely-than-not threshold for recognition of noncontractual contingencies in Statement 141(R), which are not included in revised IFRS 3. This proposed FSP requires that an asset or a liability arising from a contingency be recognized at fair value if its fair value can be reasonably 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.

C30. The proposed FSP requires an acquirer to subsequently measure a liability arising from a contingency initially recognized at fair value at the higher of (a) its acquisition-date fair value (less any reductions for the acquirer's release from risk or performance of its obligation) and (b) the amount that would be recognized if applying Statement 5 and Interpretation 14. That requirement is similar to the requirement in revised IFRS 3 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. However, unlike revised IFRS 3, the proposed FSP includes clarifying guidance that allows an acquirer to derecognize a liability arising from a contingency when the acquirer obtains new information that indicates there is only a remote possibility that the obligation will be enforced.

C31. Differences in subsequent measurement also will arise because of existing differences between IAS 37 and Statement 5 and Interpretation 14. Statement 5 requires that an estimated loss from a contingency be accrued if (a) information available prior to the issuance of the financial statements indicates that it is probable that a liability had been incurred as of the date of the financial statements and (b) the amount of the loss can be reasonably estimated. Interpretation 14 indicates that the amount of the loss can be reasonably estimated if a range of loss can be reasonably estimated. If some amount within that range appears at the time to be a better estimate than any other amount within the range, that amount must be accrued. If no amount within the range is a better estimate than any other amount, the minimum amount in the range must be accrued. In contrast, IAS 37 requires that a liability be recognized when (a) an entity has a present obligation (legal or constructive) as a result of a past event, (b) it is probable (that, is more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation, and (c) a reliable estimate can be made of the amount of the obligation. 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, make an estimate of the obligation that is sufficiently reliable. The amount recognized under IAS 37 is the best estimate of the expenditure required to settle the present obligation at the balance sheet date, which is the amount that an entity would rationally pay to settle the obligation at the balance sheet date or to transfer it to a third party at that time.

Alternative View

C32. One Board member does not support the issuance of this proposed FSP because of the complexity and lack of neutrality in the subsequent accounting for assets and liabilities arising from contingencies recognized and measured at fair value at the acquisition date of a business combination.

C33. This Board member believes that the subsequent accounting for assets and liabilities arising from contingencies recognized at fair value at the acquisition date of a business combination is extremely complex, requiring the development of the three-page flowchart presented in Appendix A of this proposed FSP. The subsequent accounting described in this flowchart for liabilities arising from contingencies recognized at fair value at the acquisition date of a business combination requires an assessment of whether the acquirer will be released from risk or fulfills its performance obligation over time. If the acquirer is neither released from risk over time nor fulfills its performance obligation over time, the subsequent accounting requires knowledge about whether (a) new information about the possible outcome of the contingency has been obtained that indicates that it has become remote that the obligation will be enforced, or (b) the acquirer has settled the liability, or (c) the obligation to settle the liability has been cancelled or expired. The subsequent accounting for assets arising from contingencies recognized at fair value at the acquisition date of a business combination also requires an assessment of whether new information has been obtained about the possible outcome of the contingency. These requirements introduce significant complexity into the subsequent accounting for assets and liabilities arising from contingencies recognized at fair value at the acquisition date of a business combination. Because of this complexity, this Board member believes that financial statement issuers would not apply the guidance in this proposed FSP consistently and that financial statement users would be confused when interpreting the financial statement effects of the proposed accounting model.

C34. In addition, this Board member also notes that the proposed subsequent measurement guidance will introduce a downward bias in the carrying values of assets and liabilities arising from contingencies after the acquisition date of the business combination by requiring (a) an asset recognized at fair value to be remeasured at the lower of its acquisition-date fair value and estimated future settlement amount and (b) a liability recognized at fair value to be remeasured at the higher of its acquisition-date fair value and the estimated future settlement amount. This Board member notes that such adjustments are inconsistent with neutral presentation of reported information as prescribed by the *Conceptual Framework* because they introduce a unidirectional downward bias in reported numbers. This Board member believes that this non-neutral presentation hinders the acquirer’s ability to communicate the financial statement effects of acquiring those contingencies in the periods subsequent to their acquisition by limiting the reporting of changes in carrying value to only those that cause losses for the reporting entity.

C35. For these reasons, this Board member believes that the proposed subsequent accounting for assets and liabilities arising from contingencies initially recognized at fair value is not likely to provide decision-useful information for capital providers and, therefore, fails any reasonable cost-benefit test for improving financial reporting.

C36. This Board member believes that the subsequent accounting for assets and liabilities arising from contingencies recognized at fair value at the acquisition date of a business combination could be simplified and would result in a neutral presentation of the economic effects of the assets acquired and liabilities assumed if the subsequent accounting required remeasurement at fair value through the date of derecognition. Under the guidance in the proposed FSP, an acquirer recognizes assets and liabilities arising from contingencies at their acquisition-date fair value only in circumstances when the acquisition-date fair value of those assets or liabilities can be reasonably determined during the measurement period. This Board member assumes that if the acquisition-date fair value of those assets or liabilities can be reasonably determined, it is likely that the subsequent fair value of those assets and liabilities also can be reasonably determined. This presumption significantly diminishes any potential measurement issues with prescribing the continued use of fair value accounting and permits the subsequent accounting to be simplified by not requiring that it be based on the discovery of new information or on the determination of whether and how the acquirer will be released from risk over time or fulfills its performance obligation over time. In addition, if the subsequent accounting is based on fair value, an acquirer can communicate both the upside and downside effects of acquiring and holding assets and liabilities arising from contingencies in the periods subsequent to the acquisition date of the business combination.

C37. This Board member also believes that if, for other reasons, it is not acceptable to require the subsequent accounting at fair value for assets and liabilities arising from contingencies initially recognized at fair value at the acquisition date of a business combination, it would be better to prescribe a consistent measurement basis for all assets and liabilities arising from contingencies in a business combination during both the initial and subsequent reporting periods than to prescribe a method that requires fair value measurement at acquisition and either a higher or lower of fair value and future settlement amount measurement basis thereafter. And, therefore, this Board member would support retaining the current guidance in Statement 141 for accounting for assets acquired and liabilities assumed in a business combination that arise from contingencies before supporting the proposed guidance in this FSP.

C38. However, this Board member's clear preference is to recognize and measure at fair value all assets acquired and liabilities assumed in a business combination that arise from contingencies at both acquisition date and in subsequent periods. Such consistent use of fair value accounting will help serve the dual objectives of (a) reducing the magnitude of noise in the goodwill number reported at the acquisition date under Statement 141(R) due to differences in the measurement bases used to measure the assets acquired and liabilities assumed in the business combination and (b) maintaining a consistent measurement basis from period-to-period that does not require unidirectional adjustments to reported carrying amounts.