

MHM Messenger

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A publication of the Professional Standards Group

FASB Amends and Clarifies Guidance on Initial Recognition and Measurement, Subsequent Measurement and Accounting, and Disclosure of Assets and Liabilities Arising from Contingencies in a Business Combination.

The Financial Accounting Standards Board (FASB) has issued FSP FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies* (the "Staff Position"). The Staff Position is 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 Staff position was issued to address various application issues and concerns identified by preparers, auditors and the legal profession arising from contingencies in a business combination.

Background

Statement 141(R) was issued in December 2007 and is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. As issued, Statement 141(R) required that all contractual contingencies and noncontractual contingencies that are more likely than not to give rise to an asset or liability be recognized at their acquisition date fair value. All noncontractual contingencies that did not meet the more-likely-than not criterion as of the date of acquisition were to be accounted for under U.S. generally accepted accounting principles (GAAP), in practice this was principally Statement No. 5, *Accounting for Contingencies*. Statement No. 141(R) also provided guidance pertaining to the subsequent measurement and accounting for such contingencies which has also been rescinded.

The Staff Position eliminates Statement 141(R)'s requirement to measure all contractual contingencies at fair value and removes the threshold for recognizing noncontractual contingencies at fair value. Additionally, the Staff Position rescinds the guidance pertaining to the subsequent measurement and accounting for such contingencies. Effectively, the FASB has reinstated most of the previous requirements for recognizing and measuring preacquisition contingencies found in Statement 141. Statement 141 required that an asset or a liability arising from an acquired contingency be recognized at fair value if fair value can be determined. Acquired contingencies whose fair value cannot be determined would only be recognized if it is probable that an asset had existed or liability incurred at the date of acquisition and the amount related to the asset or liability could be reasonably estimated. However, the FASB decided not to carry forward from Statement 141 the measurement guidance specific to warranty obligations. As a result, most warranty obligations will be recognized at fair value.

What This Means

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



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If the acquisition-date fair value of an asset acquired or a liability assumed in a business combination that arises from a contingency cannot be determined during the measurement period, an asset or a liability shall be recognized at the acquisition date if both of the following criteria are met:

- Information available before the end of the measurement period indicates that it is probable that an asset existed or that a liability had been incurred at the acquisition date.
- The amount of the asset or liability can be reasonably estimated.

If the fair value of the asset or liability cannot be determined at the acquisition date, and the acquirer concludes that either the probability criterion is not met or the amount of the asset or liability cannot be reasonably estimated, the acquirer will not recognize an asset or liability as of the acquisition date. In periods subsequent to the acquisition date, the acquirer will account for the asset or liability arising from the contingency that does not meet the criteria at the acquisition date in accordance with applicable GAAP, including Statement 5, as appropriate.

Consistent with Statement 141, the Staff Position does not provide specific accounting guidance for periods subsequent to the acquisition date. Acquirers must now develop a “systematic and rational” approach to account for acquired contingencies for periods subsequent to the acquisition date. It is likely that most companies will continue their historical practice for recognition and measurement which is largely based on a Statement 5 approach. Under this approach, the acquirer will account for the contingency in the period in which it is probable that the acquired contingency has been resolved and it can be reasonably estimated. However, because warranty obligations will initially be recognized at fair value, new practices related to warranty obligations will need to be developed by analogy to other GAAP. The Staff Position suggests that Interpretation 45 provides suitable analogous guidance and we believe it is likely to be accepted as the de facto standard.

The Staff Position also provides clarification that contingent-consideration arrangements from prior acquisitions of the target are not preacquisition contingencies and therefore are not within the scope of the Staff Position. These contingent-consideration arrangements are instead subject to the requirements of Statement 141(R).

Finally, the Staff Position requires certain disclosures pertaining to assets and liabilities arising from contingencies including the amounts recognized at the acquisition date and the basis (e.g., fair value or at an amount recognized under Statement 5 and Interpretation 14) and the nature of such contingencies. For contingencies that are not recognized at the acquisition date, the disclosure requirements of Statement 5 apply, if the criteria for disclosure in that Statement are met. An acquirer may aggregate disclosures for assets or liabilities arising from contingencies that are similar in nature.

The information in this MHM Messenger is a brief summary and may not include all the details relevant to your situation. Please contact your MHM service provider to further discuss the impact on your financial statements.