

FASB Addresses Concerns over Accounting for Litigation Contingencies in Acquisitions

On April 2, 2009, the Financial Accounting Standards Board (FASB) adopted a proposed [FASB Staff Position \(FSP\)](#) that modifies revised SFAS 141 pertaining to accounting for acquisitions. SFAS 141(R), which became effective for acquisitions consummated during a fiscal year that begins after December 15, 2008, changed several key aspects of accounting for acquisition transactions, including how acquirors account for acquired contingent assets and liabilities. The FASB's recent adoption of the proposed FSP alters the accounting treatment for acquired contingent assets and liabilities under SFAS 141(R).

Under SFAS 141(R) as originally adopted, acquirors were first required to determine whether a contingent asset or liability was contractual or non-contractual. Contractual contingencies were required to be recorded at their fair value as of the acquisition date. Non-contractual contingencies were required to be recorded at their fair value as of the acquisition date only if more likely than not to result in an asset or liability. If not more likely than not to result in an asset or liability, non-contractual contingencies were required to be accounted for in accordance with SFAS 5 (Accounting for Contingencies) and other generally accepted accounting principles.

This SFAS 141(R) requirement created concerns in particular with respect to litigation-related contingencies. These concerns included the difficulty of determining whether the contingency was more likely than not to result in a liability (and related disclosure obligations), the difficulty of determining fair value for the contingency and the risks that the auditing work required to substantiate the acquiror's assessments may result in a waiver of the attorney-client privilege.

In response to these and other concerns, the FASB modified SFAS 141(R) as it applies to all assets acquired and liabilities assumed in a business combination that arise from contingencies that would be within the scope of SFAS 5 if not acquired or assumed in a business combination, with the exception of several items subject to specific guidance in SFAS 141(R). SFAS 141(R), as now further revised, largely tracks SFAS 5, which is and has been for some time the primary accounting standard for accounting for contingent liabilities outside of the business combination context.

The FSP effecting this change to SFAS 141(R) has retroactive effect back to the date SFAS 141(R) became effective, and thus will be applicable to acquisitions consummated in the first quarter of 2009 for calendar year reporting companies.

If you have any questions about this development, please do not hesitate to contact your regular Ropes & Gray attorney.