

FASB Emerging Issues Task Force

Issue No. 09-4

Title: Seller Accounting for Contingent Consideration

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References:

FASB Accounting Standards Codification Topic 450, *Contingencies* (originally issued as Statement 5) (Topic 450)

FASB Accounting Standards Codification Topic 460, *Guarantees* (originally issued as Interpretation 45) (Topic 460)

FASB Accounting Standards Codification Topic 805, *Business Combinations* (originally issued as Statement 141(R) (Topic 805)

FASB Accounting Standards Codification Topic 810, *Consolidation* (originally issued as Statement 160 and ARB 51) (Topic 810)

FASB Accounting Standards Codification Topic 815, *Derivatives and Hedging* (originally issued as Statement 133) (Topic 815)

FASB Statement No. 5, *Accounting for Contingencies* (currently under Topic 450) (Statement 5)

FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (currently under Topic 815) (Statement 133)

*** The alternative views presented in this Issue Summary Supplement are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.**

FASB Statement No. 141, *Business Combinations* (Statement 141)

FASB Statement No. 141 (revised 2007), *Business Combinations* (currently under Topic 805) (Statement 141(R))

FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (currently under Topic 810) (Statement 160)

FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (currently under Topic 460) (FIN 45)

FASB Staff Position FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies* (currently under Topic 805) (FSP FAS 141(R)-1)

FASB Concepts Statement No. 6, *Elements of Financial Statements*

AICPA Accounting Research Bulletin No. 51, *Consolidated Financial Statements* (currently Topic 810) (ARB 51)

International Accounting Standard 39, *Financial Instruments: Recognition and Measurement* (IAS 39)

Background

1. Topic 805 requires that a buyer recognize the acquisition-date fair value of contingent consideration, as defined by Topic 805, as part of the consideration transferred to the seller in exchange for the acquiree. In addition, Topic 805 requires a buyer to remeasure contingent consideration classified as an asset or liability to its fair value through current period earnings (or other comprehensive income if the arrangement is a hedging instrument) each reporting period. This requirement to initially and subsequently recognize contingent consideration at fair value is a change from Statement 141 under which contingent consideration in a business combination typically was not recognized by a buyer at the date of acquisition but, rather, when the contingency was resolved and the additional consideration was issuable to the seller.
2. While Topic 805 does not provide guidance on seller accounting for a business combination, Topic 810, which was originally issued as Statement 160 concurrent with Statement 141(R), provides the seller's accounting for the deconsolidation of a subsidiary. In the event that a parent ceases to have a controlling financial interest in a subsidiary (including the sale of a subsidiary) and deconsolidation is required, paragraph 810-10-40-5 requires that the gain or loss recognized upon deconsolidation of a subsidiary be measured as the difference between (a) the aggregate of (1) the fair value of any consideration received, (2) the fair value of any retained noncontrolling investment in the former subsidiary at the date the subsidiary is deconsolidated, and (3) the carrying amount of any noncontrolling interest in the former subsidiary at the date the subsidiary is deconsolidated, and (b) the carrying amount of the former subsidiary's assets and liabilities.
3. Prior to Statement 160, a seller typically accounted for contingent consideration only when the contingency was *resolved* and consideration was received consistent with the gain contingency literature in Topic 450 unless the contingent consideration met the definition of a derivative under Topic 815.¹ Some constituents do not believe Topic 805 is clear as to whether contingent consideration associated with a transaction resulting in the deconsolidation of a subsidiary is required to be recognized at fair value or treated as a gain contingency. Further, if

¹ Prior to the issuance of Statement 141(R), paragraph 11(c) of Statement 133 (currently paragraph 815-10-15-74) provided a scope exception to derivative accounting for contingent consideration in a business combination. However, as clarified in paragraph 288 of Statement 133, the scope exception in paragraph 11(c) of Statement 133 only applied to buyers.

the contingent consideration is to be recognized at fair value, constituents have questioned what should be the subsequent accounting for the corresponding asset or liability.

Prior EITF Discussion

4. At the June 18, 2009 EITF meeting, certain Task Force members questioned whether this Issue should be expanded, from subsequent measurement, to address the initial measurement of seller contingent consideration². Those Task Force members observed that while one interpretation of Topic 810 could be that contingent consideration should initially be recorded at fair value, that Topic did not amend the guidance in Topic 450 for the recognition of gain contingencies. Accordingly, those Task Force members do not believe that the initial measurement of seller-contingent consideration is clear under Topic 450. After further discussion between Task Force members and FASB Board members who were present at the meeting, the FASB Chairman agreed that this Issue could be expanded to reconsider seller accounting for contingent consideration at initial measurement and also address subsequent measurement.

5. The Task Force briefly discussed subsequent measurement considerations if the initial measurement is determined to be at fair value. Because subsequent measurement guidance may be impacted by the decisions reached by the Task Force on initial measurement, the Task Force deferred further discussion on subsequent measurement and required disclosures until a future meeting.

6. One Task Force member questioned whether it was necessary to continue discussion of this Issue given that seller contingent consideration could potentially be within the scope of the FASB and IASB's joint project on accounting for financial instruments. The Task Force decided to continue discussion of this Issue because it is a current practice issue, but will continue to monitor the scope of the Boards' joint project.

7. The Task Force also determined that the scope of this Issue is limited to contingent consideration arrangements that are within the scope of Topic 810.

² The Task Force was originally asked to only deliberate on the subsequent measurement of seller accounting for contingent consideration.

Scope

8. This issue applies to contingent consideration received as part of the consideration transferred to the seller in the deconsolidation of a subsidiary that is within the scope of Topic 810. The scope of this Issue includes contingent consideration received upon deconsolidation of a subsidiary that may ultimately require the seller to deliver a financial asset to the buyer, resulting in the recognition of a liability in the seller's statement of financial position.

Accounting Issues and Alternatives

Issue 1: Whether paragraph 810-10-40-5 (and its reference to "the fair value of any consideration received") requires that a seller recognize the acquisition-date fair value of *all* contingent consideration as part of the consideration received when deconsolidating a subsidiary.

View A: Recognize the acquisition-date fair value of contingent consideration as part of the consideration received to sell a subsidiary.

9. Proponents of View A believe that Topic 810 requires a seller in a business combination to recognize the acquisition-date fair value of contingent consideration as part of the consideration received to sell a subsidiary. Paragraph 810-10-40-5 provides that the gain or loss recognized upon the deconsolidation of a subsidiary be calculated as the difference between the fair value of *any* consideration received and the carrying amount of the former subsidiary's assets and liabilities. Proponents of View A believe that the reference to "any consideration received" includes contingent consideration. In this case, contingent consideration is a component of the negotiated purchase price between a buyer and seller in exchange for the subsidiary. As described in paragraph B348 of the Basis for Conclusions to Statement 141(R), "a contingent consideration arrangement is inherently part of the economic considerations in the negotiations between the buyer and seller." Because contingent consideration is a component of the economic consideration received to sell a subsidiary, proponents of View A believe that it should be included in the seller's gain or loss calculation upon deconsolidation. Proponents of View A

also believe that the seller must recognize the contingent consideration receivable from the buyer as an asset at its acquisition date fair value.

10. Additionally, while Topic 805 addresses only the buyer's accounting for contingent consideration, proponents of View A believe that the reasons given by the Board in Statement 141(R) for modifying the accounting model for buyers are equally applicable to sellers. For example, the Board provides in paragraph B346 of Statement 141(R) that the primary reason for requiring a buyer to recognize the fair value of contingent consideration on the date of acquisition is that delayed recognition (as provided by Statement 141) ignored the fact that the buyer is unconditionally obligated to make the contingent payment. Because it is the business combination itself that is the obligating event rather than the resolution of the contingency, the Board concluded in Statement 141(R) that the buyer should recognize the fair value of contingent consideration as a liability at the date of acquisition. Proponents of View A believe that the same logic also applies to a seller in a business combination. From the perspective of a seller, a contingent consideration arrangement (which creates an unconditional obligation on the part of the buyer) creates an unconditional right on the part of the seller to additional consideration that meets the conceptual definition of an asset in Concepts Statement 6.³ Consistent with the requirement that a buyer recognize a liability for its unconditional obligation to transfer additional consideration to the seller, proponents of View A believe that a seller should recognize its unconditional right to receive additional consideration as an asset at the date of acquisition.

11. Proponents of View A also note that requiring a seller to recognize its right to additional consideration as an asset is consistent with the requirement in Topic 805 that a buyer recognize its right to the return of previously transferred consideration (that is, the buyer's recognition of reverse contingent consideration). While not as common, the Board acknowledged in paragraph B364 of Statement 141(R) that the conceptual basis for requiring recognition of a contingent consideration liability at the date of acquisition also applies to reverse contingent consideration.

³ Paragraph 25 of Concepts Statement 6 defines an asset as a "probable future economic benefit obtained or controlled by a particular entity as a result of past transactions or events."

In this case, the buyer's right to the return of previously transferred consideration is an asset that must be recognized at fair value at the date of acquisition.⁴

12. Opponents of View A contend that paragraph 810-10-40-5 does not specifically require that contingent consideration be included in the gain or loss calculation upon deconsolidation of a subsidiary. Because recognizing contingent consideration upon deconsolidation represents a fundamental change to current practice, opponents of View A believe that the Board would have discussed such a change in the standard or the Basis for Conclusion to Statement 160 if it was intended. Because there is no mention of contingent consideration in Topic 810 and because Topic 805 only applies to the buyer's accounting in a business combination, opponents of View A do not believe Topic 810 requires immediate recognition by a seller of a contingent consideration arrangement.

View B: Recognize contingent consideration in accordance with Topic 450.

13. While Topic 810 states that the fair value of any consideration received for the sale of a subsidiary shall be included in the gain or loss calculation upon deconsolidation, proponents of View B do not believe that the Board intended for the calculation to include contingent consideration. This is supported by the fact that the Board does not elaborate on the reference to "any consideration received" in the Basis for Conclusions to Statement 160. View B proponents believe that if the Board intended for contingent consideration to be included as part of the consideration received in the sale of a subsidiary, such a conclusion would warrant discussion in Statement 160's Basis for Conclusions given the magnitude such a change would have on current practice and to be consistent with the extensive discussion of the accounting for contingent consideration that was included in Statement 141(R).

⁴ Specifically, paragraph B346 of Statement 141(R) states the following:

The same is true for a right to the return of previously transferred consideration if specified conditions are met. Failure to recognize that... right at the acquisition date would not faithfully represent the economic consideration exchanged at that date. Thus, both Boards concluded that... rights associated with contingent consideration arrangements should be measured and recognized at their acquisition-date fair values.

14. Further, proponents of View B believe that the Board would have provided subsequent measurement guidance if it intended for the gain or loss calculation to include contingent consideration. Because no subsequent measurement guidance is provided in Topic 810 for consideration received to sell a subsidiary, proponents of View B believe that this further supports the view that the Board did not intend for Topic 810 to change how a seller accounts for contingent consideration.

15. Finally, proponents of View B note that Topic 805 only addresses the buyer's accounting for a business combination, including the accounting for contingent consideration. As was the case prior to the issuance of Topic 805, View B proponents believe that there continues to be no specific literature in U.S. GAAP that provides explicit guidance on the accounting by a seller for contingent consideration unless the contingent consideration meets the definition of a derivative instrument in Topic 815. As a result, proponents of View B believe that the gain contingency model in Topic 450 should continue to be followed consistent with the accounting for any contingency that may result in a gain for which no explicit guidance exists.

16. Opponents of View B believe that Topic 810 does provide explicit guidance on the seller's accounting for contingent consideration. Further, that guidance is consistent with the buyer's accounting in Topic 805. Because a liability (asset) to the buyer is an asset (liability) to the seller, opponents of View B believe that the seller's accounting for contingent consideration should be symmetrical with that of the buyer.

Issue 2: If the Task Force chooses View A on Issue 1, how the seller should subsequently account for contingent consideration.

View A: Subsequently remeasure contingent consideration to fair value through current period earnings.

17. Consistent with the buyer's accounting in Topic 805, View A proponents believe that a seller in the deconsolidation of a subsidiary should subsequently measure contingent consideration at fair value through current period earnings. Proponents of View A believe that

the rationale provided by the Board in Statement 141(R) for requiring a buyer to continually remeasure contingent consideration equally applies to sellers.

18. In paragraph B349 of Statement 141(R), the Board acknowledged that most contingent consideration arrangements are financial instruments and that many meet the definition of a derivative instrument. Statement 141(R) deleted the derivative scope exception in paragraph 815-10-15-74 related to a buyer's accounting for contingent consideration. Paragraph B355 of Statement 141(R) discusses the Board's conclusion that "in concept, all liabilities for contingent consideration should be accounted for similarly," and that all "liabilities for contingent payments not accounted for as derivative instruments should also be remeasured at fair value after the acquisition date." Proponents of View A believe that this argument also applies to the subsequent accounting for a seller's rights to additional consideration in a business combination. Because all contingent consideration arrangements should be accounted for alike and because many are derivatives, proponents of View A believe that an asset recognized for the right to future consideration in a business combination should also be remeasured to fair value subsequent to the date of acquisition.

19. In addition, proponents of View A believe that a remeasurement model that requires all changes in fair value to be reflected in earnings will result in entities reporting economic gains and losses immediately, thus improving financial statement transparency. Measuring assets and liabilities, specifically financial instruments, at fair value provides more current information about a financial instrument, provides better information about the current wealth of an entity than any other single measure, and provides users with information so that they can assess the entity's prospects for future cash flows.

20. Opponents of View A contend that the Board's decision in Topic 805 to require a buyer to subsequently measure contingent consideration arrangements to fair value through current period earnings was an exception made specific to buyers. Because of the inherent difficulty in subsequently measuring the fair value of contingent consideration, opponents of View A believe that a seller should follow another model that does not require remeasurement at fair value each reporting period.

21. Opponents of View A also believe that contingent consideration received in a business combination is a financial instrument. However, they believe that the right to future consideration in the deconsolidation of a subsidiary usually results in an asset that has similar characteristics of a receivable financial instrument, which is not typically remeasured to fair value through current period earnings each reporting period under current GAAP unless the fair value option is elected. These opponents believe that the accounting consequences for similar assets should be the same.

View B: Do not subsequently remeasure contingent consideration to fair value through current period earnings; account for the contingent consideration received in accordance with Topic 450.

22. Proponents of View B believe that no specific guidance exists requiring a seller to subsequently measure contingent consideration at fair value through current period earnings (unless the contingent consideration arrangement meets the definition of a derivative pursuant to Topic 815).

23. Further, proponents of View B contend that it is not practical for a seller to continually measure contingent consideration at fair value. In many cases, it will be difficult for a seller to determine the fair value of contingent consideration subsequent to the date of acquisition, especially when a seller does not have access to the appropriate information that is necessary to measure the fair value of contingent consideration on a continual basis. Examples of those situations are when the contingent consideration is based on earnings or other performance targets of the former subsidiary and no contractual provisions were included that provide the seller with access to detailed financial information.

24. Proponents of View B believe that the right to future consideration usually results in an asset with similar characteristics of a receivable financial instrument, which is not typically remeasured to fair value through current period earnings each reporting period. These proponents believe that similar assets should be accounted for consistently, resulting in contingent

consideration being recognized at its initial fair value and tested for impairment in accordance with paragraph 450-20-25-2.⁵ Increases in the value of the contingent consideration would also be accounted for in accordance with Topic 450 as a gain contingency.

25. Paragraph 450-20-25-2 requires an estimated loss from a loss contingency to be accrued by a charge to income if both of the following conditions are met:

- a. Information available before the financial statements are issued or are available to be issued (as discussed in Section 855-10-25) indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements.... It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss.
- b. The amount of loss can be reasonably estimated.

26. Proponents of View B note that there are situations in which a contingent consideration arrangement may result in the seller being required to record a liability. Proponents of View B do not propose providing any specific guidance for subsequently accounting for contingent consideration arrangements that result in a liability. Proponents of View B believe that contingent consideration arrangements that result in a liability are generally guarantees subject to the guidance in Topic 460.

27. Although the initial recognition and measurement provisions in Topic 460 do not apply to a guarantee for which the underlying is related to the performance (regarding function, not price) of nonfinancial assets that are owned by the guaranteed party, such arrangements are still within the scope of Topic 460. Paragraph 460-10-35-1 indicates that Subsection 460-10-35 does not describe in detail how a guarantor's liability for its obligations under a guarantee would be measured after initial recognition but that the liability would typically be reduced as the guarantor is released from risk under the guarantee. Paragraph 460-10-35-2 notes that depending on the nature of the guarantee, the guarantor's release from risk has typically been recognized over the term of the guarantee using one of the following three methods: (a) only upon expiration

⁵ An alternate impairment model is to calculate the impairment charge consistent with other-than-temporary-impairment guidance (that is, reduce the recorded value to the current fair value, and recognize the change in current period earnings).

or settlement of the guarantee, (b) by a systematic and rational amortization method, or (c) as the fair value of the arrangement changes.

28. Proponents of View B believe that a decision not to provide specific guidance on the subsequent accounting for contingent consideration arrangements that result in a liability is consistent with the guidance in Topic 460 and consistent with the Board's decision in FSP FAS 141(R)-1 to require that acquirers subsequently account for assets and liabilities arising from contingencies in a business combination using a systematic and rational basis depending on their nature.

29. Opponents of View B believe that the remeasurement model required in Topic 805 for contingent consideration should also be applicable to sellers. Thus, the seller should remeasure contingent consideration to its fair value through current period earnings each reporting period. Opponents also believe that fair value provides more useful information to users of financial statements.

30. In addition, opponents of View A note that there are situations in which the contingent consideration may result in the seller being required to record a liability. Opponents believe that a fair value measurement most faithfully represents that obligation.

31. Finally, opponents of View B do not believe that practicability of a fair value measurement is a sufficient basis for determining whether an asset or liability should be subsequently measured to fair value. In fact, opponents of View B point to the fact that the Board rejected that argument when determining whether contingent consideration should be initially measured at fair value on the date of acquisition. In paragraph B347 of Statement 141(R), the Board acknowledged the difficulty in measuring the fair value of contingent consideration arrangements. However, the Board concluded that "to delay recognition of, or otherwise ignore, assets or liabilities that are difficult to measure would cause financial reporting to be incomplete and thus diminish its usefulness in making economic decisions." While this reference is from the perspective of the buyer, proponents of View A believe that the same argument applies to subsequent measurement of contingent consideration from the perspective of the seller.

Disclosure

32. The FASB staff recommends that the following disclosures be made in annual financial statements for which the seller has a right to additional consideration received in a business combination. This disclosure could be required regardless of the Task Force's conclusion on Issue 1.

For each annual reporting period after the disposal until the seller collects, sells, or otherwise loses the right to a contingent consideration asset, the seller shall disclose the following information for each material right to additional consideration received:

- i. Amount recognized
- ii. Description of the arrangement, range of outcomes, and the basis for determining the amount to be received (or paid)
- iii. Any change in the recognized amounts, including any differences arising upon settlement
- iv. Any changes in the range of outcomes and reasons for those changes.

If rights to individually immaterial arrangements for additional consideration are material in the aggregate, the information required above shall be disclosed in the aggregate.

Transition and Effective Date

33. The effective dates of both Statement 141(R) and Statement 160 were for fiscal years beginning after December 15, 2008. The staff believes that a consensus on this Issue should be effective for new transactions as soon as possible, given that the effective dates of both Statement 141(R) and Statement 160 have passed.

34. The Task Force is also being asked what transition should be required for a consensus reached in this Issue.

View A: A consensus should be effective immediately for new transactions. For all other transactions, a consensus should be effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2009. The consensus would require retrospective application to deconsolidation transactions for which the transaction date was on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Earlier application by an entity that has previously adopted an alternative accounting policy is permitted.

35. View A proponents believe that many entities may not be able to implement the change in the interim period after the issuance of this Issue. However, they believe that some entities may wish to early adopt. View A opponents believe that early adoption should not be permitted as it may reduce the comparability between different reporting entities.

View A': A consensus should be effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2009. The consensus would require retrospective application to deconsolidation transactions for which the transaction date was on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Earlier application by an entity that has previously adopted an alternative accounting policy is not permitted.

36. This view is the same as View A; however, it would not require immediate adoption for new transactions. Proponents believe that View A' allows for the benefit of consistency and comparability for all future transactions and does not result in non-comparability in an annual reporting period. View A' opponents believe that there is generally a lack of comparability between entities' accounting for asset acquisitions and business combinations because each transaction is unique and therefore a lack of comparability should not be persuasive.

View B: A consensus should be effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2009. The guidance in this Issue shall be applied to contingent consideration initially received on or after the effective date of Statement 160. The cumulative effect of the change in accounting principle shall be recognized as an adjustment to

the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that fiscal year, presented separately. The cumulative-effect adjustment is the difference between the amounts recognized in the statement of financial position before initial application of this Issue and the amounts recognized in the statement of financial position at initial application of this Issue. Earlier application by an entity that has previously adopted an alternative accounting policy is not permitted.

37. This view requires the guidance to be adopted through a cumulative effect adjustment. View B proponents note that if the Task Force reaches a tentative consensus for View A of Issue 1 that it could require entities that had not previously been remeasuring contingent consideration at fair value through earnings to attempt to determine the fair value of the contingent consideration for prior periods. These opponents believe that the information required to determine the fair value of the contingent consideration in an earlier period may not be available and therefore believe that cumulative effect adoption would be preferable.

International Convergence

38. It is the staff's belief that there are differing views in practice as to whether seller contingent consideration is initially recognized at fair value and subsequently remeasured to fair value through current period earnings under IAS 39.

Interaction with Other Board Agenda Projects

39. If the contingent consideration meets the definition of a financial instrument, it may be within the scope of the Board's accounting for financial instruments project. However, that project does not yet have a finalized defined scope and it is uncertain whether contingent consideration arrangements will be within the scope of that project.