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Memo ID Memo: The Engagement Team Partner RE: Accounting for a Loss Contingency for a Verdict Overturned on Appeal Background

The company M has been involved in a long-standing patent infringement litigation case with W a competitor in the business. The case involved the following issues:

Filing for patent infringement claims by W against the company M in May 2007.

Consideration of a loss estimated within \$15 million to \$20million with the company settling at \$17million as the probable amount range in the year ended December 31, 2007.

Jury trial of September 2009 led to the award of \$18. 5 million to W based on the verdict reached.

M Company filed for appeal on December 2009 in the Court of Appeal, which reversed the ruling on the matter on December 2010.

W filed for a rehearing of the case by the same appellate court that overturned the verdict but was denied and hence M considering the matter closed.

Issues:

The company needs to identify what to record as a liability in its financial statements for the year ended December 31, 2007.

Is there a need for M to adjust its liability for the year ended December 31, 2009? What amount is recorded and for which year?

Should the effect of the appeal take place in 2010 or 2011 in the records of M and their financial statements?

Guidance

ASC 450-10, Contingencies Overall

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According to the contingencies 450-10, 05-5, a resolution of an uncertainty involving the incurrence of a liability or an occurrence that includes inherent uncertainties provides contingencies. Through this, the standards in recording contingencies are developed in accounting and financial reporting.

ASC 855, Subsequent Events, Recognized Subsequent Events

In the recognition of subsequent events, consideration of all available evidence on the conditions existing in the year for the date that the balance sheet covers prove reasonable and necessary. According to 25-1 of the same, a company shall recognize or provide for all recognized subsequent events provided the availability of additional evidence in their financial statements considering the availability of this information during the date of the balance sheet or the development of the financial statements.

ASC 410-30 Asset Retirement and Environmental obligations

In cases that a probability exist weighing on which a liability has been incurred provides for the reasonable estimation of the liability. 25-8 provides for the creation of the recognition of a loss contingency once the range in which the loss falls is probable for estimation (Accounting Standards Codification, n. d). In the same context, the retirement of an asset proves possible once the uncertainties provided become certain, and the company comprehends the effect caused in totality.

Application

During the development of the financial statements of December 31, 2007, the company needed to provide for the uncertainty in its records and based on the estimate developed, it proved necessary to include the rough estimate of \$17million in the financials as liability. During the year 2009, the record of the liability stated as \$17 million needed amending since the ruling <https://assignbuster.com/writting/>

had been made on the case providing for \$18 million despite the appeal holding.

In 2010, W filed for appeal against the ruling of the court of appeal on the matter. This leaves uncertainty still surrounding the matter and hence the need to continue holding the liability stated in the books. According to the ASC 410-30 dealing with asset retirement, it is only recognized once fully ascertained which ascertainment occurred in 2011 after W lost the appeal. It is, therefore, prudent for the effect of the appeal to occur in 2011 in the financials of M.

Conclusion

The company needs to have all the liabilities recognized the right and recorded in the books of accounts based on the Accounting Standards provided. These all provide for the company to have its books and reports run in accordance with the accounting principles providing a true and fair view in the company's records. Despite this need, a liability needs to be recognized at the right time and recorded to provide for probable losses and derecognized when it's certain of the proceeds of it.

References:

Accounting Standards Codification, (n. d). 410 Asset Retirement and Environmental Obligations. Viewed on April 27, 2015 from <https://asc.fasb.org/section&trid=2175690>