

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

31 July 2008

Request for Comments on a Proposed Statement, *Disclosure of Certain Loss Contingencies, an amendment of FASB Statements No. 5 and 141 (R)* (File Reference No. 1600-100)

Dear Mr. Golden:

We appreciate the opportunity to comment on the Proposed Statement, *Disclosure of Certain Loss Contingencies* (the "proposed Statement"). We agree with the FASB that financial statement users benefit from disclosures that assist in assessing the likelihood, timing, and amount of future cash flows associated with loss contingencies that are (or would be) recognized as liabilities in a statement of financial position. However, both the true benefits and costs of providing certain disclosures must be carefully considered. The obvious costs of providing the proposed expanded disclosures include the considerable time and effort of financial statement preparers, legal counsel and independent auditors in preparing, vetting and auditing the proposed disclosures. However, more significantly, these costs include the potential effects of disclosing prejudicial information and the risks to attorney-client privilege, as well as the likely need to revisit the agreements between auditors and attorneys on the nature of information provided by attorneys in response to audit-related legal inquiries. While we understand the objectives noted in the proposed Statement, we have significant concerns about whether the proposal would achieve those objectives and whether the benefits of any incremental disclosures outweigh the costs. Our concerns are further described below.

The proposed Statement requires disclosure of those loss contingencies with a likelihood of loss that is remote when a severe impact could result in the near term. This is a significant expansion of the scope of the current disclosure requirements and could raise difficult implementation issues, especially for unasserted loss contingencies. We believe that the cost of identifying these loss contingencies, especially those related to unasserted claims, may not be justified by the benefits to users. We also believe that providing meaningful disclosures about these loss contingencies will be difficult. In our experience, of greater concern for financial statement users is the lack of meaningful disclosure related to loss contingencies with a likelihood of loss that is more than remote. We believe that requiring disclosure of a greater number of potential loss contingencies will not improve compliance with the current or proposed disclosure requirements.

The proposed Statement significantly expands the disclosures required for loss contingencies. We believe that in some instances, the expanded disclosures will be of limited incremental value to

financial statement users while potentially being harmful to current investors in the disclosing entity. Although we strongly support the Board's objective of providing investors with transparent, timely and useful information, disclosures of certain loss contingencies such as pending and threatened legal claims would likely be useful to the disclosing entity's adversaries. While we are not experts in legal matters and are therefore not in a position to express detailed views on what types of disclosures could prejudice the outcome of a contingency, we believe that the risks of disclosing prejudicial information are significant. Further, given the complexity and unpredictability of the litigation process, this disclosure could expose the company to additional risk of litigation if the ultimate resolution of the contingency differs materially from the disclosed estimates. Given these concerns, we strongly support the Board's plans to conduct field testing before deciding whether to finalize the proposed Statement and recommend that legal counsel be a key contributor to that process (perhaps through participation by the American Bar Association (ABA)). Moreover, we believe that reaching out to a diverse group of financial statement users, including current investors, is critical to the Board's consideration of the potential costs and benefits of the proposed expanded disclosures.

As auditors, we need information from legal counsel to evaluate the appropriateness of the entity's accounting for and disclosure of litigation, claims, and assessments. The proposed Statement will result in a need for more information, including information about the prejudicial nature of the related disclosures. These assessments are not within the realm of an auditor's expertise. SAS 12, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*, reflects an accommodation between the accounting and legal professions providing a means for auditors to obtain relevant and reliable evidential matter concerning the existence of litigation, claims, and assessments—pending, threatened, and unasserted—while recognizing the public interest in protecting the confidentiality of lawyer-client communications. The ABA has adopted a "Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information" (ABA Statement of Policy), under which lawyers accept certain responsibility for responses to auditors' inquiries. Conversely, auditors have agreed to accept certain limitations on lawyers' responses regarding unasserted claims and assessments as well as their evaluation of the potential outcome of litigation matters and, as a result, rely heavily on the lawyer's statement of professional responsibility.

The requirements of the proposed Statement will place significant tension on existing attorney-client privilege concerns. Legal counsel, in advising clients on the need for disclosure, is often inclined to minimize disclosures that could be useful to the company's adversaries and could themselves be the source of litigation. As a result, we believe that reliance on the prejudicial exemption is likely to be more pervasive than intended by the proposed Statement. Similarly, we believe that the disclosure of remote loss contingencies will be infrequent because entities likely will conclude that such contingencies are not expected to be resolved in the near term or are not expected to have a severe impact. In fact, we believe that legal counsel frequently will conclude that it is unable to provide the estimates required by the proposed Statement. Counsel also may advise clients not to make disclosures (because of concerns about discovery and prejudice) or not to make their own estimates of exposure (because of concerns about their ability to make a reasonable estimate). Further, clients often will be unwilling to divulge to auditors confidential information received from legal counsel so as not to jeopardize attorney-client privilege. Auditing the disclosures about these loss contingencies will thus become increasingly challenging. The tensions between preparers, legal counsel, auditors, and the disclosure objectives of the proposed Statement likely will result in

significant cost and effort that, in the end, will provide little incremental disclosure that is of use to users of financial statements.

Given that the Board plans a comprehensive reconsideration of the recognition and measurement of certain nonfinancial liabilities, including contingencies, we urge the Board to address the disclosure of loss contingencies in conjunction with deliberation of a new recognition and measurement model, rather than revising the disclosure requirements under the current recognition and measurement standards. We believe this approach would give the auditing and legal professions a better opportunity to work towards a revised approach to providing independent auditors the information necessary to audit both any potential newly required measurements of contingencies¹ as well as any new disclosures required for those contingencies.

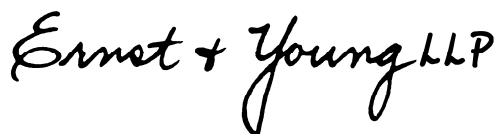
If the Board proceeds with the proposed Statement, we strongly believe that the proposed transition period will not be sufficient for entities to appropriately prepare for the expanded disclosure requirements. The Board will need time to complete its analysis, hold roundtables, and redeliberate its conclusions to arrive at a final Statement. Preparers will then need time to establish processes, gather information, and draft required disclosures while conferring with legal counsel to consider the prejudicial nature of the disclosures and the appropriate level of aggregation. Moreover, auditing guidance on the expanded disclosures likely will need to be developed and the ABA Statement of Policy reconsidered. Such reconsideration will involve revisiting the delicate balance previously negotiated between the audit and legal professions, a process which we expect would result in lengthy negotiation and debate. We would therefore recommend an effective date no earlier than fiscal years beginning after December 15, 2009, depending on when a final Statement is issued.

Please refer to the Appendix to this letter for our detailed comments and suggestions in response to the questions in the proposed Statement.

* * * * *

We would be pleased to discuss our comments with the Board members or the FASB staff at your convenience. As we previously communicated, we also would like the opportunity to participate in the planned roundtables on the proposed Statement.

Very truly yours,



¹ Under FASB Statement No. 141 (R), *Business Combinations*, certain contingent liabilities assumed in a business combination occurring after the effective date of that standard (years beginning after December 15, 2008) must be recognized by the acquirer and measured at fair value. Specifically, contractual contingent liabilities, as well as noncontractual contingent liabilities that more likely than not meet the definition of a liability in FASB Concepts Statement No. 6, *Elements of Financial Statements*, must be measured at fair value. The assessment of a more-likely-than-not threshold and measurement at fair value represent significant changes in practice not contemplated by the current ABA Statement of Policy and may require reconsideration of that document.

Responses to Questions in the Proposed Statement of Financial Accounting Standards, *Disclosure of Certain Loss Contingencies, an amendment of FASB Statements No. 5 and 141(R)*

Question 1—Will the proposed Statement meet the project's objective of providing enhanced disclosures about loss contingencies so that the benefits of those disclosures justify the incremental costs? Why or why not? What costs do you expect to incur if the Board were to issue this proposed Statement in its current form as a final Statement? How could the Board further reduce the costs of applying these requirements without significantly reducing the benefits?

We believe that the costs of identifying loss contingencies with a likelihood of loss that is remote, especially those related to unasserted claims, is not justified by the benefits to users and that providing meaningful disclosures about these loss contingencies will be difficult and subject to second guessing with hindsight. We believe that the disclosure of remote loss contingencies will be infrequent because entities likely will conclude that such contingencies are not expected to be resolved in the near term or are not expected to have a severe impact, and those judgments will be extremely difficult to audit. Accordingly, we recommend that these disclosures not be required as discussed further in our response to Question 3.

We also believe that preparers will incur significant legal and auditing costs associated with certain of the proposed disclosure requirements, particularly those of a forward-looking nature. For example, disclosure of the maximum possible loss, the timing of resolution, and factors that are likely to affect the ultimate outcome of the contingency, and the qualitative assessment of the most likely outcome of the contingency, all are forward-looking disclosures that would appear to expose the preparer to considerable risks of litigation if those estimates prove significantly different than the actual resolution of the contingency. Those disclosures also raise significant auditing challenges. We believe entities will incur significant legal and auditing costs as preparers, counsel and auditors debate the merits of any proposed disclosures and the judgments involved in those disclosures. The tension between the auditor's need to obtain all relevant information about litigation and the attorney's desire to limit such information to maintain attorney-client privilege will only increase those costs.

We also believe that incremental costs to financial statement issuers include the cost of potentially larger legal settlements resulting from the disclosure of prejudicial information. Our concerns about prejudicial disclosures are discussed in our responses to Questions 8-10.

Question 2—Do you agree with the Board's decision to include within the scope of this proposed Statement obligations that may result from withdrawal from a multiemployer plan for a portion of its unfunded benefit obligations, which are currently subject to the provisions of Statement 5? Why or why not?

We agree that obligations that may result from withdrawal from a multiemployer plan for a portion of its unfunded benefit obligations should be included in the scope of the proposed Statement. These obligations are contractual in nature and generally result from an employer's discretionary decision

to withdraw from the plan. We do not believe that an employer would typically make such a decision if it would result in a severe impact to the entity and, therefore, we believe that there will be few, if any, instances when disclosure would be required incrementally to the current rules.

We understand that in certain instances the maximum exposure to loss from these obligations may be somewhat uncertain due to the formulaic nature of the liability. The information needed by an employer to make this assessment must be obtained from the multiemployer plan administrator and may not always be available significantly in advance of when an employer makes a decision to withdraw from a plan. However, we believe that this information will ultimately be collected by the employer during its assessment process prior to deciding whether to withdraw from the plan and that timely disclosure of the information would be helpful to financial statement users.

Question 3—Should an entity be required to provide disclosures about loss contingencies, regardless of the likelihood of loss, if the resolution of the contingencies is expected to occur within one year of the date of the financial statements and the loss contingencies could have a severe impact upon the operations of the entity? Why or why not?

Providing meaningful disclosures about remote loss contingencies, especially those related to unasserted claims or assessments, will be difficult and will subject entities to second guessing by those who have the benefit of hindsight. Moreover, the determination as to what could have a severe impact in the near term is highly judgmental, and will be assessed by legal counsel who is often inclined to minimize disclosures that could be useful to the company's adversaries and that could themselves be the source of litigation. Further, legal counsel is discouraged from estimating the potential amount of loss or range of loss by the ABA Statement of Policy. The Policy states that the amount or range of potential loss is inherently impossible to ascertain, and that it would be appropriate for legal counsel to provide such an estimate only if he or she believes that the probability of inaccuracy of the estimate is slight.

In our experience, of greater concern for financial statement users is the lack of meaningful disclosure related to loss contingencies with a likelihood of loss that is more than remote. We believe that requiring disclosure of a greater number of potential loss contingencies whose outcome is deemed remote will not improve compliance with the current or proposed disclosure requirements and could prove misleading to users of financial statements.

Question 4–Paragraph 10 of Statement 5 requires entities to “give an estimate of the possible loss or range of loss or state that such an estimate cannot be made.” One of financial statement users’ most significant concerns about disclosures under Statement 5’s requirements is that the disclosures rarely include quantitative information. Rather, entities often state that the possible loss cannot be estimated. The Board decided to require entities to disclose the amount of the claim or assessment against the entity, or, if there is no claim or assessment amount, the entity’s best estimate of the maximum possible exposure to loss. Additionally, entities would be permitted, but not required, to disclose the possible loss or range of loss if they believe the amount of the claim or assessment is not representative of the entity’s actual exposure.

- a. Do you believe that this change would result in an improvement in the reporting of quantitative information about loss contingencies? Why or why not?**
- b. Do you believe that disclosing the possible loss or range of loss should be required, rather than optional, if an entity believes the amount of the claim or assessment or its best estimate of the maximum possible exposure to loss is not representative of the entity’s actual exposure? Why or why not?**
- c. If you disagree with the proposed requirements, what quantitative disclosures do you believe would best fulfill users’ needs for quantitative information and at the same time not reveal significant information that may be prejudicial to an entity’s position in a dispute?**

Question 5–If a loss contingency does not have a specific claim amount, will an entity be able to provide a reliable estimate of the maximum exposure to loss (as required by paragraph 7(a)) that is meaningful to users? Why or why not?

We agree conceptually with the benefits of disclosing quantitative information about the amount of the claim or, if the claim has not been quantified by the plaintiff, the estimated maximum amount of loss. We are concerned however, that some of the proposed quantitative disclosures may be prejudicial in nature as well as potentially misleading given that many cases are settled for amounts that are a fraction of the damages alleged. While we are not experts in legal matters and are therefore not in a position to express detailed views on what types of disclosures could prejudice the outcome of a contingency or whether an entity will be able to provide a reliable estimate of the maximum exposure to loss, we believe that the risks of disclosing prejudicial information are significant.

The Board has acknowledged preparer concerns related to the risk of disclosing disaggregated information about recognized loss contingencies, noting that it could be used against the disclosing entity in legal disputes. The proposed Statement therefore allows disclosure of amounts recognized for all loss contingencies to be aggregated in the tabular reconciliation. We share these concerns and moreover believe them to be equally valid for the proposed disclosures of forward-looking quantitative and qualitative information.

The proposed Statement assumes that the amount of the claim is an objective amount that is publicly available. This is not the case for many lawsuits, such as class actions under federal and state securities laws. Without an objective claim amount, the proposed Statement would require disclosure of the best estimate of the maximum exposure to loss. Disclosure of this amount may be highly useful to the disclosing entity's adversaries. Further, given the complexity and unpredictability of the litigation process, this disclosure could itself be the source of litigation if the ultimate resolution of the contingency differs materially from the disclosed estimates. Moreover, often the maximum possible exposure to loss is an enormous amount that bears little relation to the final loss, if any, and will result in incremental disclosure that is of little use to financial statement users, who will understand that the likelihood of a loss of such magnitude is remote.

As the disclosure of possible loss or range of loss would be supplemental to the qualitative disclosures and the amount of the claim (or maximum potential loss), we agree that this disclosure should be optional, and that this decision is appropriately left to the judgment of management and legal counsel.

Our recommendations for incremental disclosures are described in our response to Question 13.

Question 6—Financial statement users suggested that the Board require disclosure of settlement offers made between counterparties in a dispute. The Board decided not to require that disclosure because often those offers expire quickly and may not reflect the status of negotiations only a short time later. Should disclosure of the amount of settlement offers made by either party be required? Why or why not?

We agree with the Board that disclosure of settlement offers should not be required for the reasons noted by the Board. In addition, settlement offers may represent a negotiation tactic with no correlation to the ultimate amount of the loss, thus providing little value to financial statement users. If, however, a settlement offer is made by a defendant, we believe that fact must be considered in the context of determining the minimum potential loss under FASB Statement No. 5, *Accounting for Contingencies* and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss* and, therefore, may already be reflected in the tabular reconciliation.

Question 7—Will the tabular reconciliation of recognized loss contingencies, provided on an aggregated basis, provide useful information about loss contingencies for assessing future cash flows and understanding changes in the amounts recognized in the financial statements? Why or why not?

We understand that the tabular reconciliation of recognized loss contingencies may provide useful information to financial statement users in some circumstances. Information about past losses, while not necessarily indicative of future losses, may give users important historical information that may inform their estimates of future losses.

The proposed Statement also requires a qualitative description of the significant activity in the tabular reconciliation. We suggest that the Board provide examples of these qualitative disclosures at an allowable aggregated level, as well as those required by paragraph 7 of the proposed Statement, to assist preparers. It is not clear how qualitative information about individual loss contingencies can

be aggregated in a way that would be helpful to financial statement users. We believe that in field testing these disclosures the Board also should carefully consider the concerns about prejudice and attorney-client privilege discussed in greater detail elsewhere in this letter.

Question 8—This proposed Statement includes a limited exemption from disclosing prejudicial information. Do you agree that such an exemption should be provided? Why or why not?

Question 9—If you agree with providing a prejudicial exemption, do you agree with the two-step approach in paragraph 11? Why or why not? If not, what approach would you recommend and why?

Question 10—The International Accounting Standards Board (IASB) continues to deliberate changes to IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, but has not yet reconsidered the disclosure requirements. The existing disclosure requirements of IAS 37 include a prejudicial exemption with language indicating that the circumstances under which that exemption may be exercised are expected to be *extremely rare*. This proposed Statement includes language indicating that the circumstances under which the prejudicial exemption may be exercised are expected to be *rare* (instead of *extremely rare*). Do you agree with the Board's decision and, if so, why? If not, what do you recommend as an alternative and why?

We strongly agree with the Board that an exemption from disclosing prejudicial information is needed. We are not, however, experts in legal matters and are therefore not in a position to provide specific views on what types of disclosures could prejudice the outcome of a contingency.

The field testing conducted by the Board should encompass input from legal counsel (perhaps through participation by the ABA), as well as a diverse group of financial statement users, to gain an understanding of which disclosures may be prejudicial (e.g., could influence the actual settlement amount), whether the proposed aggregation of information will provide useful information to financial statement users, and the potential cost of those disclosures.

The two-step approach proposed by the FASB seems like a reasonable first step in accommodating concerns about prejudicial information, subject to the input of parties with more knowledge of the US legal system. However, we do not believe that the FASB has sufficient experience with the proposed disclosures to provide a basis for concluding that the use of the prejudicial exemption would be rare or extremely rare (both of which are likely to be interpreted as “never” by regulators). We would recommend that the Board not include any judgments about the frequency of the use of such exemption, as that judgment appears rather speculative and designed to make the exemption extremely difficult to use. At a minimum, we believe the Board should offer such a view only after extensive field testing. As a practical matter, we believe entities may be inclined to make the subjective judgment that potential disclosures are prejudicial and thus not required.

Question 11—Do you agree with the description of *prejudicial information* as information whose “disclosure . . . could affect, to the entity’s detriment, the outcome of the contingency itself”? If not, how would you describe or define *prejudicial information* and why?

In cases where an entity’s loss contingencies are of similar nature, the disclosure of prejudicial information could affect not only the outcome of the contingency itself, but also similar contingencies, both present and future. We therefore believe that the Board’s definition should be expanded to encompass the outcome of the contingency itself and other similar contingencies.

Question 12—Do you believe it is operational for entities to disclose all of the proposed requirements for interim and annual reporting periods? Should the tabular reconciliation be required only annually? Why or why not?

We believe that the disclosure requirements of the proposed Statement should apply only to annual reporting periods as the existing regulatory framework requiring interim information (APB Opinion No. 28, *Interim Financial Reporting* and Regulation S-X, Article 10) results in appropriate interim disclosures. For example, Rule 10-01 (a) (5) of Regulation S-X provides that disclosures in the notes to the annual financial statements need not be repeated in Form 10-Q unless, among other things, there has been a significant change in a balance or estimate, or the disclosure relates to a “material contingency.” We believe these requirements are adequate and, therefore, the proposed Statement need not specify interim disclosure requirements.

Question 13—Do you believe other information about loss contingencies should be disclosed that would not be required by this proposed Statement? If so, what other information would you require?

We believe that any incremental disclosures required by the proposed Statement should focus on the facts of significant claims. For example, for contingencies that are at least reasonably possible to result in a significant transfer of assets, we believe that disclosures about the events that are the basis for the plaintiff’s allegation, the legal basis for the claim, the developments associated with the claim to date, and the legal conclusions that likely will determine the outcome of the claim should be provided. We believe that these disclosures should be provided in sufficient detail so that financial statement users, perhaps with advice of legal professionals, can make an independent assessment of the entity’s exposure. We believe that such disclosure for significant contingencies will be more useful than aggregated disclosures or disclosures that require the entity to predict highly uncertain outcomes or could give plaintiffs valuable information to use against the defendant in settlement negotiations.

Question 14—Do you believe it is operational for entities to implement the proposed Statement in fiscal years ending after December 15, 2008? Why or why not?

We do not believe that the proposed transition period will be sufficient for entities to appropriately prepare for the expanded disclosure requirements. Comment letter analysis, ample field testing, and redeliberation of conclusions will result in very little time for implementation prior to the effective date. Moreover, when the final disclosure requirements are known, preparers will need time to appropriately:

- Gather the required information for analysis, which will be a significant task for many companies who may not have gathered all the required information previously.
- With the assistance of legal counsel, draft the required disclosures, many of which would not previously have been provided (especially for remote loss contingencies).
- Determine how the qualitative and quantitative disclosures may be aggregated in a manner that is helpful to financial statement users.
- Confer with legal counsel to carefully determine whether any of the required disclosures are prejudicial in nature.
- Establish appropriate internal controls over these processes, which will affect the process of reporting under the requirements of Section 404 of the Sarbanes-Oxley Act.

Additionally, the Public Company Accounting Oversight Board (PCAOB), as well as the Auditing Standards Board of the American Institute of Certified Public Accountants (AICPA), will likely conclude that it should provide guidance on auditing these expanded disclosures. Furthermore, the Treaty² as adopted by the AICPA and the ABA may need to be reevaluated by the AICPA, ABA and the PCAOB, to determine whether it is adequate to address issues that will arise with auditing any incremental disclosures. The development of new guidance and the analysis and possible amendment of the Treaty will require some time. If the analysis results in recommended changes to the Treaty, the negotiation process is likely to take considerable time. We do not believe that the proposed transition period provides sufficient time for these processes to be completed.

We would recommend an effective date no earlier than for fiscal years beginning after December 15, 2009, depending on when a final Statement is issued.

² The "Treaty" is comprised of two documents: the ABA Statement of Policy and SAS 12.