



ILLINOIS CPA SOCIETY.



LETTER OF COMMENT NO. 419

August 6, 2008

Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856-5116

File Reference No. 1600-100

Dear Sir/Madam:

The Accounting Principles Committee of the Illinois CPA Society (Committee) appreciates the opportunity to provide its perspective on the Exposure Draft of the Proposed Statement of Financial Accounting Standards *Disclosure of Certain Loss Contingencies*. The organization and operating procedures of the Committee are reflected in the attached Appendix A to this letter. These recommendations and comments represent the position of the Illinois CPA Society rather than any members of the Committee or of the organizations with which such members are associated.

The Committee recommends the Board defer the issuance of the proposed standard until the International Accounting Standards Board completes its deliberations. With the current climate being one of moving towards convergence, we believe it inappropriate for the Board to make radical changes in reporting standards that may disadvantage US reporting entities in the short term and be reversed upon adoption of IFRS in a few short years.

We believe the Board and the IASB should deliberate the measurement and recognition criteria of SFAS No. 5 and IAS No. 37. If cash flow information is really important, as has been asserted in the Conceptual Frameworks of both standard setting bodies, then the Board and the IASB should look to set standards that contribute to the disclosure of that information. It may be that the two boards ultimately converge to a probability-weighted measurement process for both loss and gain contingencies with both tabular and sensitivity disclosure. However, a major change in US reporting along those lines should be done only in concert with full and open deliberations by both the Board and the IASB.

Our comments in response to the questions raised in the document are as follows:

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?*

It is not clear to the Committee that the Financial Accounting Standards Board (the "Board") has in fact identified real benefits related to the enhanced disclosures. In particular, the Board states that constituents desire additional information related to loss contingencies for the purpose of better assessing the timing and amounts of future cash flows. However, if the concerns expressed are legitimate, then we question the apparent absence of requests for the same enhanced information related to gain contingencies which obviously also impact the timing and amount of future cash flows. The Committee is therefore not convinced that the concerns expressed to the Board are in fact related to the need to better predict future cash flows and, accordingly, we are not convinced that there are in fact real benefits to be realized from such enhanced disclosures.



ILLINOIS CPA SOCIETY.

In addition to the direct costs such as increased attorney and audit fees, associated with any enhanced disclosures, the Committee believes there may be hidden or indirect costs that are not subject to quantification in advance. In particular, the potential costs that may arise in the course of a reporting entity's negotiations with adverse parties who may use the enhanced disclosures to their advantage or potential costs associated with disclosures required of those entities reporting in accordance with US GAAP as compared to those reporting in accordance with IFRS.

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?*

The Committee is not aware of any controversies surrounding the reporting of multiemployer plan withdrawal obligations under existing pronouncements. The recognition and/or disclosure called for by SFAS No. 132(R) are clear. The Board has not provided any rationale as to the need for this enhanced disclosure. If the benefit identified by the Board relates to users' ability to assess timing and amount of future cash flows, then disclosure of a future event that is not reasonably possible or probable of occurrence is not relevant to that assessment.

The Committee understands that a multiemployer plan must provide a participating employer an estimate of its withdrawal liability upon request and those estimates are not routinely calculated and provided to all participating employers on a recurring basis. Has the Board considered the cost to multiemployer plans of having their actuaries perform these calculations for all participating employers, not all of whom have the same year end, in time for those employers to include such information in their annual reports and make their reporting deadlines?

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?*

The Committee believes the disclosures contemplated are neither relevant nor beneficial. For loss contingencies whose probability of occurrence is remote, the assertion that they could have a severe near-term impact on the financial statements is illogical. It appears that the Board is convinced that reporting entities are being less than truthful in their assessment that probability of occurrence is remote, particularly in situations where resolution is expected within one year. If that is the case, then this is an issue of failing to follow GAAP, whether SFAS No. 5 or SOP 94-6, not an issue requiring enhanced disclosure and such issue should be discussed with the SEC, PCAOB or AICPA as well as with the reporting entities in question.

The Committee is concerned that the inclusion of large numbers of cases, especially frivolous ones, will mask the actual exposure. There is an emerging body of academic research indicating that the "wordiness" of MD&A increases as news gets worse in an attempt to discourage users from reading the document or to overwhelm them with information in order to hide relevant disclosures.

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,*



ILLINOIS CPA SOCIETY-

*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?*

As noted above, if the Board believes that users are not complying with the requirements of existing GAAP related to disclosure of ranges of loss, then this is not a matter to be resolved by additional accounting pronouncements. It is the experience of the members of the Committee that, with respect to litigation and claims, outside counsel is often the source of the position that the estimate of an amount or a range is not possible nor is an estimate of a maximum loss possible. In the absence of estimates from outside counsel, particularly in those situations where damages are not specified, The Committee does not believe management will be able to make such estimates.

*If reporting entities comply with the requirements of SFAS No. 5 as well as SOP 94-6, we believe users will have the necessary information they need to assess amounts of future cash flows. However, both users and the Board are no doubt aware that the timing of many such future cash flows is in the hands of the judicial system and not susceptible of estimation.*

- 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?*

*In situations where damages are not specified, especially in those for which outside counsel is unable (or unwilling) to estimate a maximum possible loss, how will management be able to make such estimates? What will be its basis for doing so and what independent, objective information will auditors have to attest to those disclosed estimates?*

- 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's decision.

- 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?*

The Committee believes such tabular reconciliation is appropriate and is consistent with the Board's approach in recent pronouncements (e.g., SFAS No. 157, FIN 45 and FIN 48). Having to set forth its experience will allow users to judge the forthrightness of management's estimates of recorded liabilities and will highlight those situations where management has not followed GAAP. The fear of having to potentially re-state for failing to disclose reasonably possible amounts in one quarter when a major accrual is made the next quarter will deter the non-compliant behavior with which the Board appears to be concerned. However,



ILLINOIS CPA SOCIETY.

the Committee notes that users can already make those assessments. Information on catastrophic lawsuits that have not previously been disclosed eventually becomes known. Accordingly, we believe users (and regulators) already have the necessary information to determine whether management is biased or not forthright in its estimation processes or its disclosures, and are in a position to assess management's compliance with the provisions of SFAS No. 5 and SOP 94-6.

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?*

The Committee believes that the U.S. legal system often times functions as a bargaining tool with plaintiffs trying to pressure companies into settling cases which may in fact be frivolous. It's not clear that the Board has the expertise to understand what information may in fact be prejudicial or where it may be located. It seems logical to the Committee that the increased time that management and the auditors will spend in this area will also increase the time and the associated fees of outside counsel.

The documentation required of auditors would necessarily increase to include much more commentary related to these proposed enhanced disclosures. As auditors' working papers are subject to discovery by plaintiffs, expanded "mining" of auditor working papers will increase the costs of the audit firms and the exposure of the defendants/auditees. Consistent with our previous comments, the exemption is not necessary if the enhanced disclosures are not required. However, the exemption is appropriate if this standard goes forward.

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?*

The Committee has no comment on the two-step approach.

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?*

The Committee believes the Board should refrain from issuing standards that require disclosures in the US that are not required of foreign filers following IFRS, particularly disclosures of this magnitude and this radically different.

It is not clear to the Committee that there is a distinction between "rare" and "extremely rare". The qualifier appears redundant at best.

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?*

The Committee agrees, but suggests the Board seek comment from the American Bar Association and others who are knowledgeable in this area.



ILLINOIS CPA SOCIETY.

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?*

Public companies make quarterly disclosures of legal and other contingencies already. As noted above, recent pronouncements include full disclosure requirements in interim periods. The Board should be consistent in its requirements for quarterly disclosures.

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?*

As noted above, the Committee believes the existing requirements of SFAS No. 5 and SOP 94-6 are sufficient to make financial statements relevant to users. Also as noted above, we believe that users who are legitimately concerned about their ability to assess the timing and amounts of future cash flows should be requesting information not just for loss contingencies, but for gain contingencies as well.

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?*

As this Committee has stated in previous comment letters to the Board, the rush to implement changes at year end is both unwise and unnecessary. We do not believe there is a pressing need to issue a statement of this nature at all, let alone with a current year effective date.

We appreciate the opportunity to offer our comments.

Sincerely,

**John Hepp, CPA**  
Chair, Accounting Principles Committee



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APPENDIX A  
ILLINOIS CPA SOCIETY  
ACCOUNTING PRINCIPLES COMMITTEE  
ORGANIZATION AND OPERATING PROCEDURES  
2008-2009

The Accounting Principles Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members appointed from industry, education and public accounting. These members have *Committee service ranging from newly appointed to more than 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of accounting standards. The Committee's comments reflect solely the views of the Committee, and do not purport to represent the views of their business affiliations.*

The Committee usually operates by assigning Subcommittees of its members to study and discuss fully exposure documents proposing additions to or revisions of accounting standards. The Subcommittee ordinarily develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times, includes a minority viewpoint.

Current members of the Committee and their business affiliations are as follows:

**Public Accounting Firms:**

**Large:** (national & regional)

John A. Hepp, CPA	Grant Thornton LLP
Alvin W. Herbert, Jr., CPA	Retired/Clifton Gunderson LLP
Michael J. Maffei, CPA	BDO Seidman LLP
Matthew G. Mitzen, CPA	Virchow Krause & Company, LLP
Reva B. Steinberg, CPA	BDO Seidman LLP
Jeffery P. Watson, CPA	Blackman Kallick LLP

**Medium:** (more than 40 employees)

Barbara Dennison, CPA	Selden Fox, Ltd.
Marvin A. Gordon, CPA	Frost, Ruttenberg & Rothblatt, P.C.
Ronald R. Knakmuhs, CPA	Miller, Cooper & Co. Ltd.

**Small:** (less than 40 employees)

Walter J. Jagiello, CPA	Walter J. Jagiello, CPA
Kathleen A. Musial, CPA	BIK & Company LLP

**Industry:**

John M. Becerril, CPA	Cabot Microelectronics
Gloria M. Evans-Melton, CPA	National Council of State Boards of Nursing
Melinda S. Henbest, CPA	The Boeing Co.
James B. Lindsey, CPA	TTX Company
Laura T. Naddy, CPA	Gaming Capital Group
Anthony Peters, CPA	McDonald's Corporation

**Educators:**

James L. Fuehrmeyer, Jr. CPA	University of Notre Dame
David L. Senteney, CPA	Ohio University
Leonard C. Soffer, CPA	University of Chicago

**Staff Representative:**

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