



LETTER OF COMMENT NO. 148

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*Via Email*

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**Re: Comments to Exposure Draft – Disclosure of Certain Loss Contingencies**

Dear Mr. Golden:

Pursuant to the formal request for comments by the Financial Accounting Standards Board (FASB) on the Exposure Draft, the Council On State Taxation (COST) submits the following comments regarding the Draft's major impact on state and local taxes. COST's primary concern with the FASB Exposure Draft covering the Disclosure of Certain Loss Contingencies is that the incremental cost to comply with these new provisions will likely be incurred again in the near future with the convergence of the FASB Statements and the International Accounting Standards Board (IASB) Statements. COST believes these changes should be delayed and addressed when FASB converges its contingency disclosure provisions in FAS Statements 5 and 141(R) with those of IAS 37. COST suggests that the FASB carefully consider the state and local tax issues before finalizing any guidance on FAS 5 and FAS 141(R).

**About COST**

The Council On State Taxation (COST) is a nonprofit trade association based in Washington, D.C. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce. Today, COST has grown to have an independent membership of more than 600 major corporations engaged in interstate and international business. COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.

COST members are geographically diverse and almost all of COST's members are subject to FASB's rules and will incur costs to comply with this Exposure Draft.

### Specific Comments to FASB Questions on Exposure Draft

COST offers the following detailed responses to the questions proffered by FASB.

**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?

*COST Response: Most of COST's members are engaged in international business and the differing accounting standards applied by FASB and IASB can result in an inconsistent treatment when comparing financial statements of entities using the two different standards. It is not cost efficient to require entities complying with FASB to incur additional costs in the near future when the convergence of the FAS Statements 5 and 141(R) and IAS 37 are expected. The primary and potentially overwhelming problem with applying the Exposure Draft in the state and local tax arena is the sheer number of jurisdictions that impose such taxes and the non-uniformity among those jurisdictions. Forty-five states and thousands of local jurisdictions impose sales and use taxes. The vast majority of these jurisdictions impose unique taxes; all of these jurisdictions have varying interpretive regulations and judicial opinions. The result is a mind boggling number of unique laws with which a taxpayer must not only attempt to comply, but, under the Exposure Draft, must evaluate and document that such a position as well as the IAS 37 Standard. COST members must deal with the complexities of multiple state and local taxes. The detailed quantitative and qualitative analyses required under this proposed Exposure Draft outweigh any benefits, especially since these same onerous standards are not required under IAS 37. Accordingly, COST believes the best way to control costs and ensure any additional benefits are fairly applied to entities using FASB or IASB financial reporting, is to initiate any changes when the convergence of FAS Statements 5 and 141(R) and IAS 37 take place.*

**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?

*COST Response: At the present time, COST has no position on this issue.*

**Question 3.** Should an entity be required to provide disclosure 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?

*COST Response: See question 1, COST is concerned that entities complying with FASB statements will be at a disadvantage to those using IASB 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?

*COST Response: COST believes the use of "the maximum possible exposure to loss" can be extremely misleading and may lead to inaccurate financial disclosure that leans too far towards overstating the degree of contingent loss. It may also, similar to FIN 48, lead to state and local revenue officials misinterpreting this financial reporting as an acknowledgement that such disputed tax (contingent loss) is owed.*

- 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?

*COST Response: Disclosure of a potential range of loss is much preferred over reporting the maximum possible loss. However, as stated above, COST believes the convergence issues between FAS Statements 5 and 141(R) and IAS 37 should be addressed first.*

- 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?

*COST Response: Because many tax disputes can be quite complex, often times a qualitative disclosure is more responsive than a quantitative disclosure. The present standards used in IAS 37 do not require disclosure of remote loss contingencies regardless of the expected timing of resolution or potential severity of the contingency. This is preferred over the disclosure requirements in this Exposure Draft.*

**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?

*COST Response: COST does not believe that reporting the maximum exposure is meaningful to users. In fact, its reporting and misinterpretation of risk by others (as seen by state and local revenue officials with FIN 48) could be used to an entity's detriment in addressing a tax dispute. COST recommends that IAS 37 standards be used instead of those in this Exposure Draft.*

**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 discloser 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?

*COST Response: COST agrees with the Board that settlement offers should not be disclosed. Besides the valid point addressed by the Board that the offers often expire quickly, it will be counterproductive to the settlement process because the parties to these disputes often seek confidentiality.*

**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?

*COST Response: COST's biggest concern, as addressed in several questions above, is that the FASB and IASB standards related to contingent losses should be the same. It is extremely important to COST that the amounts be aggregated since disclosure of specific tax contingencies would be prejudicial to the entity in a state and local tax dispute.*

**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?

*COST Response: COST strongly believes an exemption is needed for disclosing prejudicial information. COST is concerned that the exemption is too limited and has the potential to be unfairly used to negotiate settlements or influence the results of litigation against the reporting entity.*

**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?

*COST Response: Similar to the response to question 8, COST is very concerned that even having to disclose the reason why the information has not been disclosed in a state and local tax controversy can unfairly be used against the reporting entity. With respect to state and local tax issues, the specific items required to be addressed, such as describing the factors likely to affect the ultimate outcome of the contingency, may unfairly provide state and local revenue officials with information that creates an unlevel playing field.*

**Question 10.** The 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 the language indicating that the circumstances under which that exemption may be exercised 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?

*COST Response: Again, similar to the responses provided in question 1, 3 and 4, COST would like to see a convergence of FAS Statements 5 and 141(R) and IAS 37 before any changes are instituted. However, COST would favor use of a prejudicial exemption in rare circumstances (not extremely rare).*

**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?

COST Response: *COST agrees with that the description but stresses that the required disclosures are too strict, as noted in questions 8 and 9.*

**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?

COST Response: *At the present time, COST has no position on this issue.*

**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?

COST Response: *COST’s concern is that this Exposure Draft requires too much information to be disclosed that will not primarily assist users of the financial information, but will be used to adversely impact the reporting entity in a dispute, particularly for state and local tax disputes.*

**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?

COST Response: *As stated in several of the responses to the above questions, COST believes this Exposure Draft should be delayed until there is a convergence of FAS Statements 5 and 141(R) with IAS 37.*

#### Closing

COST responded by e-mail on July 25, 2008 that it was interested in participating in a public roundtable meeting. COST appreciates the opportunity to express its views in this letter and a subsequent roundtable meeting to address the issues COST has raised regarding this Exposure Draft. If you have any questions, please contact Fred Nicely at [FNicely@statetax.org](mailto:FNicely@statetax.org).

Sincerely,



Fred Nicely

cc: COST Board of Directors