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LETTER OF COMMENT NO. 174

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Technical Director - File Reference No. 1600-100 Order Department Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, Connecticut 06856-5116 director@fasb.org

PricewaterhouseCoopers LLP appreciates the opportunity to provide comments on the FASB's Proposed Statement of Financial Accounting Standards, *Disclosure of Certain Loss Contingencies – an amendment of FASB Statements No. 5 and 141(R)* (the "proposal").

We support the FASB's goal of helping financial statement users better assess the likelihood, timing, and amount of future cash flows associated with loss contingencies. We acknowledge that the proposal will provide users with considerably more information about loss contingencies than they currently receive. However, some of this information will be quite fluid because of the evolving nature of most contingencies and therefore could be misleading, despite management's best efforts in developing it. That will place undue strain on the user community as it struggles to evaluate the extent to which it can base decisions on such information. And, largely because of the unique nature of the U.S. legal environment, the proposal is likely to place undue strain on preparers, the legal community, and the auditing profession due to the fact that maintaining the privity of what is typically highly sensitive information is critical to a company's successful legal defense. Accordingly, we believe the proposal has the potential to result in unintended costs that outweigh the intended benefits to users of having more information about a company's loss contingencies.

We therefore urge the FASB to further study this matter. Because of the unique challenges posed by the U.S. legal environment, we believe an important first step should be to demonstrate that the perceived imperfections of the current disclosures about loss contingencies warrant change. Without sufficient support for increased disclosures, it would seem premature to dramatically revise the current disclosure requirements, particularly given the concerns about providing the proposed disclosures in the current U.S. legal environment. Therefore, it will be important to ensure that whatever disclosures are proposed pass a robust test of relevance and reliability and thus will meaningfully inform but not mislead financial statement users.

We encourage the FASB to consider the following.

The Importance of Relevance and Reliability

Because of the inherent uncertainty surrounding loss contingencies, estimating certain potential losses (e.g., an entity's maximum exposure to loss), particularly for early-stage contingencies, will require subjective inputs and assessments by management and legal counsel. While an estimate may appear to be reasonable at the time of the assessment, it will undoubtedly prove wrong over time because, as the matter progresses, new developments occur, and new information is revealed that will affect the outcome of the contingency. Thus, regardless of the best efforts of management in providing such disclosures, the actual losses may be materially different than the estimates provided, especially for early-stage contingencies (including unasserted claims). Accordingly, such disclosures can be misleading and therefore of little, if any relevance to investors who make decisions based on such information, and could even cause the early disclosures themselves to be the subject of litigation. Also, by requiring management to provide such disclosures, and auditors to opine on them, a false sense of credibility may be instilled in those who rely on the estimates.

An appropriate objective for the standard should be for companies to disclose estimates that are reliable and relevant. The Board may wish to consider at what point in the life of a contingency a reliable estimate can be made. While that could be highly dependent on the relevant facts and circumstances, it is important to determine whether, for example, any perceived inadequacies of today's disclosures is a consequence of the inability to reach a conclusion that a loss is reasonably possible at an earlier date.

The Impact of the U.S. Legal Environment

We understand that the proposal is intended to address investor concerns that the current disclosure requirements for loss contingencies under FAS 5 are not adequate or timely. At a time when many are calling for increased transparency of financial information, the proposal reveals the natural tension between greater transparency and the potential consequences that may come with it. In this case, that tension is heightened because of the difficulties of providing the proposed information in the U.S. legal environment and the potentially significant adverse consequences that disclosure of such information could have for a company's legal strategy and the ultimate resolution of the matter. For example, both the legal and preparer communities have expressed concerns that the proposed disclosures could expose a company's legal strategy and provide plaintiffs with information that could compromise the company in litigation or in settlement negotiations. Although the proposal provides that in "rare" instances information that is deemed to be prejudicial could be exempt from disclosure, we understand that the remaining required disclosures could still be prejudicial to the outcome of the contingency.

In making the case for change, the Board and its constituents need to be confident that the proposed disclosures will improve the relevance and reliability of financial reporting and that the FASB's goal of better informing financial statement users is balanced against the challenges of developing and presenting that information in today's legal environment.

The Need to Revise the "Treaty"

The nature and subjectivity of the proposed disclosures will create a challenge for auditors to understand management's assessments and obtain sufficient evidence to support them. Further, management may hesitate to provide this evidence based on concerns that the information constitutes legal advice the company has received from counsel. We have been informed that providing such information could jeopardize the attorney-client privilege, attorney work-product doctrine, and other legal protections. We understand that if disclosure is made and information is provided to the auditors, that information might be held to be subject to discovery by the plaintiff. On the other hand, by withholding such information, management runs a risk that the company's auditors would be unable to opine on financial statements containing the proposed disclosures.

If the proposal were to be finalized in its current form, we believe revisions to the "treaty" between the legal and auditing professions would have to be made for auditors to obtain adequate corroborating evidence to support management's assertions. For example, the treaty currently provides guidance to lawyers not to confirm a range of loss amount unless the range provided has "only a slight chance of being inaccurate." We recommend the Board acknowledge the limitations placed on the legal profession by the treaty and work with the legal profession and other affected parties to revise the treaty to accommodate any new disclosures that may be proposed. This would seem particularly appropriate given that similar tensions will likely exist with regard to measurement of acquired contingencies at fair value under FASB Statement No. 141 (Revised), *Business Combinations* (FAS 141(R)). Therefore, the treaty may need to be revised regardless of the outcome of the proposal and the Board's assistance in that process would be beneficial.

* * *

In light of the foregoing and our more detailed comments that follow in the attachments to this letter, we urge the Board to consider whether there is a clear mandate for broad changes in the current disclosure requirements for loss contingencies. Specifically, the FASB should consider how existing disclosures are being impacted by the litigation environment in the United States, which a new financial accounting and reporting standard cannot rectify. To the extent the Board believes that a case has been made for increased disclosure, we urge the Board to work closely with the legal community, companies, investors, regulators, and auditors to more fully contemplate the proposal's implications and address constituents' concerns. In doing so, consider:

- Whether the proposal would achieve the FASB's stated objectives;
- How feasible the proposed disclosures are from an operational standpoint (e.g., whether management and its legal counsel can determine reliable estimates and whether the disclosures would be auditable);
- How legal proceedings and parties would be affected;

¹ The "Treaty" is comprised of two documents: the ABA Statement of Policy Regarding Lawyer's Responses to Auditors Request for Information, and the AICPA Statement of Auditing Standards No. 12.

- How the proposal would impact the attorney-client privilege and other legal protections,
- How the treaty between the legal and auditing professions will need to be revised to accommodate the new disclosures; and
- The possible benefit of redeliberating the proposal in conjunction with the IASB's efforts to amend IAS 37, with the goal of issuing a single converged international standard that provides guidance on recognition, measurement and disclosures related to loss contingencies.

If the Board were to move forward with the current proposal, we believe it would be impracticable for companies to change the controls and processes necessary, and for the treaty to be amended, to meet the requirements related to these disclosures of loss contingencies in their 2008 annual financial statements. We recommend that the FASB consider the length of time it will take for these changes to occur and delay any proposal's effective date accordingly. We would expect that it would take at least a year.

If further study confirms that new disclosures are needed, please consider our responses to the specific questions contained in the Exposure Draft, included in Appendix A. Additionally, in Appendix B we recommend certain clarifications and editorial changes.

If you have any questions regarding our comments, please contact Michael J. Gallagher at (973) 236-4328, Raymond J. Beier at (973) 236-7440, or John R. Formica, Jr. at (973) 236-4152.

Sincerely,

PricewaterhouseCoopers LLP

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Appendix A - Response to Questions:

FASB Proposed Statement of Financial Accounting Standards, Disclosure of Certain Loss Contingencies – an amendment of FASB Statements No. 5 and 141(R)

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 providing the enhanced disclosures will be more costly for companies since it will entail developing new processes and internal controls, as well as additional resources to assess contingencies and draft the necessary disclosures. Companies will also incur additional external legal costs in obtaining, compiling, and verifying evidence that supports the enhanced disclosures. In addition, companies would likely incur more audit costs as auditors institute additional procedures and engage in greater interaction with management and the company's legal counsel to corroborate management's supporting assertions and key assumptions with respect to the expanded disclosures and to assess the completeness of those disclosures.

The enhanced disclosures could also result in the following unintended "costs" and consequences:

- A company's litigation strategy could be compromised, potentially affecting the
 outcome of the contingency in a manner detrimental to the company, which in
 turn might make it more costly to resolve the matter.
- The attorney-client privilege, the attorney work-product doctrine, and other litigation protections could be compromised, possibly giving plaintiffs access to information that would otherwise not be available to them.
- Auditors might be unable to opine on the disclosures if companies cannot
 provide the supporting information because to do so would breach the attorneyclient privilege. Companies that withhold such information consequently run
 the risk that their auditors might be unable to issue an unqualified audit
 opinion.
- Disclosures that ultimately prove wrong might lead to future litigation and cause unnecessary concern among users.

Although not a cost directly linked to the preparer community, modification of the treaty between the legal and auditing professions will be necessary to ensure that the appropriate amount of corroborating evidence will be available to a company's auditors for purposes of supporting management's assertions.

Despite the benefits of enhanced disclosures, we believe that the benefits will be outweighed by corresponding incremental costs. Those costs might be reduced if the Board were to do the following:

- Eliminate the requirement to disclose remote loss contingencies that are deemed to have a severe and near-term impact.
- Require disclosures of quantitative and qualitative information that is already a
 matter of public record, similar to the disclosures currently required of public
 companies under Item 103 of SEC Regulation S-K.
- Expand the prejudicial exemption.

We discuss these recommended changes in more detail in our responses to the questions below.

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 with the Board's decision to include within the scope of this proposal obligations that may result from withdrawal from a multiemployer plan for a portion of its unfunded benefit obligations. Withdrawals from multiemployer plans are loss contingencies within the scope of FAS 5 and therefore should be treated no differently than other loss contingencies that must be disclosed under the proposal. However, many of our concerns (articulated in this letter) about the extent of the proposed disclosure requirements also apply to the proposed disclosures for withdrawals from multiemployer plans.

One concern, for example, is that employers might not have access to the underlying information they would need for purposes of estimating the maximum exposure to loss that must be disclosed under the proposal. That information would come from a third-party plan sponsor, who would receive significant input from its actuaries. Currently, significant time is required to develop such information — more time than plan administrators and actuaries would be given under the proposal, which requires that such information be disclosed quarterly. In dealing with multiemployer plans, IAS 19, *Employee Benefits*, acknowledges that some companies might not have access to the information needed to apply defined benefit accounting, and therefore provides a disclosure alternative. It would be helpful if the FASB were to incorporate a similar solution in its final standard.

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?

We do not believe that entities should provide such disclosures. The disclosures might raise unwarranted concerns among users of the financial statements (for instance, disclosures related to a remote loss contingency could lend credibility to a case that might have no legal merit), could expose the company to second-guessing in the likely event that circumstances change, and will likely be onerous for a company to provide. Such additional disclosures would increase the overall volume of disclosures for loss contingencies, requiring investors and other

users of financial statements to spend more time discerning the more relevant disclosures from boiler-plate information.

We believe that an adequate threshold of disclosure is provided for in AICPA Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, which does not require disclosures for remote loss contingencies.

In addition, if the FASB ultimately decides to retain paragraph 6, it would be helpful if that paragraph were to clarify what is meant by the phrase "or combination of loss contingencies." We assume that a company would not have to make such disclosures if all its loss contingencies that have been deemed immaterial could be severe in the aggregate.

- 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?

No. The legal and preparer communities have expressed concerns that estimating the potential maximum loss, especially for early-stage litigation or an unasserted claim, would be extremely challenging and would likely result in unreliable information. The factors potentially affecting the outcome of the eventual case may be numerous and fluid, with many of them outside the company's control, making their potential impact on the outcome hard to determine. Additionally, the legal community has noted that an estimate of a maximum exposure to loss might not be relevant in relation to a company's actual exposure to loss and, therefore, may not be useful to investors in assessing a company's true exposure related to a loss contingency.

We understand that once disclosed this information could be used against the company, either in the courtroom or in negotiations. A company's loss estimate, therefore, could turn into a self-fulfilling prophecy. There is also the distinct possibility that the disclosed estimate would turn out to be wrong, potentially leading to yet further litigation by investors and other users of the financial statements, who may argue that they relied on the disclosed estimate in making investment or other business decisions.

Regarding the claim amount, while such amounts are generally a matter of public record, including such information in the footnotes may be useful to investors. While the claim may not be indicative of the actual loss, it would provide investors with factual information. Refer to our response to question 4.c.

We also believe that the disclosures set out in paragraph 7.c., which relate to insurance and indemnification arrangements, should not be required. Such disclosures would allow plaintiffs to determine the amount a company could recover under an insurance arrangement; which could serve to establish a floor for the settlement amount.

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?

We do not believe that such disclosure should be required. The legal community has expressed concern that providing the best estimate of possible loss or a range of loss may be even more prejudicial to a company than disclosing the maximum exposure to loss. Disclosure of that estimate may be perceived as an acknowledgement of fault and as management's settlement floor.

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?

We believe that further research would be helpful in determining whether additional disclosure is needed to fulfill users' needs for quantitative information and to determine whether the proposed disclosures would meet the proposal's stated objectives. If, however, the FASB moves forward with the proposal, we would recommend that only information that is a matter of public record be disclosed, since that information may be useful to users but would not be prejudicial in a legal dispute. Such disclosure would be similar to the disclosures currently required of public companies under Item 103 of SEC Regulation S-K.

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 believe that in some instances the maximum exposure to loss can be reliably estimated if the calculation is based on an operation of law (e.g., applicability of an exemption from use tax for a specific purchase of property) or a particular damages provision in a contract. In other instances, however, a company might be unable to provide a reliable (and therefore meaningful) estimate of the maximum exposure to loss, particularly for early-stage litigation, environmental contingencies, unasserted claims, and withdrawals from multiemployer plans. The information and assessments used in calculating such exposures depend on many factors, both legal and factual, not all of which are within the company's control. Such inputs may change throughout the life of a loss contingency — they are based on information available at a given time but might not be predictive of the ultimate loss. Therefore, we believe that the Board should continue to allow companies to state that a reasonable estimate cannot be made, if such a statement is factual and supportable.

If the Board were to proceed with the proposal, paragraph 7a in the proposal could be revised accordingly:

- 7. An entity shall disclose the following information about loss contingencies required to be disclosed under paragraph 5 or 6:
 - a. Quantitative information about the entity's exposure to loss from the contingency (including any amounts already recognized in the financial statements but excluding potential recoveries disclosed under paragraph 7(c)), as follows:
 - (1) The amount of the claim or assessment against the entity (including damages, such as treble or punitive damages), if applicable
 - (2) If there is no claim or assessment amount, the entity's best estimate of the maximum exposure to loss if that amount
 - Can be determined by operation of law or by contract, or
 - Can otherwise be reasonably estimated
 - (3) If an estimate of the maximum exposure to loss is not disclosed because such an amount cannot be (a) determined by operation of law or by contract or (b) reasonably estimated, the entity shall state that such an estimate cannot be made and the reason(s) for it.

An entity also may disclose its best estimate of the possible loss or range of loss if it believes that the amount of the claim or assessment or the maximum exposure to loss is not representative of the entity's actual exposure.

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 not to require disclosure of settlement offers made between counterparties in a dispute. We agree that offers can expire quickly and not reflect the status of negotiations only a short time later. Additionally, the settlement offer may have no correlation to the ultimate settlement amount; nor does it necessarily indicate that settlement is imminent. Such disclosure could also potentially inhibit the making of such offers, which is contrary as a public policy matter to the goal of an efficient legal system.

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 believe that the tabular reconciliation, provided on an aggregated basis, may provide useful information about certain loss contingencies for assessing future cash flows and understanding changes in the amounts recognized in the financial statements. Such

information would bring greater transparency to recorded loss contingency amounts in the financial statements. However, we understand that disclosure of changes in recorded amounts, along with disclosure of the reasons for such changes, could be highly prejudicial, since, for example, those disclosures might reveal the company's thinking and strategy on a major piece of litigation. We also understand that courts often consider this information so prejudicial that they decline to admit it as evidence. Therefore, it is important that the information presented in the reconciliation not be prejudicial.

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?

Yes, we agree that an exemption from disclosing prejudicial information should be provided. However, we believe that the limited exemption included in the proposed Statement should be expanded. Additionally, we do not think that cases in which companies would have to disclose prejudicial information would be "rare." We understand that both the legal and preparer communities believe that many of the proposed disclosures would hinder a company's ability to defend itself in litigation and that the exemption might therefore need to be used frequently. For example, many companies have only one material litigation case, which aggregated disclosure would be unlikely to mask, and so the company's legal position would be compromised if the proposed disclosures were made. Further, including the notion that the prejudicial exemption would be rare we believe would create tension for a company and its legal counsel in justifying the company's use of the exemption to users, regulators and auditors. Companies may also be exposed to further litigation by plaintiffs (e.g., investors) who challenge management's use of the exemption in a particular case.

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?

We believe that in many instances this two-step approach will not be effective in achieving the objective of providing a prejudicial exemption.

The legal profession has indicated that many companies do not have more than one pending claim or lawsuit of significance at a given time. Therefore, providing the required disclosures for such a case, even if they are aggregated at a level higher than "by the nature of the contingency," would make it easy for plaintiffs to discern which case the disclosures relate to. Further, aggregating a company's litigation disclosures into a larger category of disclosure (for instance, environmental and litigation-related contingencies) might also not protect compromising details about a specific legal case. Ultimately, a company's disclosures could, in many instances, be sufficiently revealing that they would render moot the protection that the prejudicial exemption is meant to provide.

We believe that even after applying the second step of the prejudicial exemption, whereby a company could forgo disclosing the prejudicial information, the minimum quantitative and qualitative disclosures required in all circumstances could still be prejudicial, negatively affecting the outcome of the contingency. If the FASB moves forward with the proposed

standard, we recommend that all disclosures be subject to the prejudicial exemption and therefore, suggest revising paragraph 11 as follows.

...In those circumstances, an entity may aggregate the disclosures required by paragraph 7 at a level higher than by the nature of the contingency such that disclosure of the information is not prejudicial. In those-rare instances in which the disclosure of the information required by paragraph 7, when aggregated at a level higher than by the nature of the contingency, or of the tabular reconciliation would be prejudicial (for example, if an entity is involved in only one legal dispute), the entity may forgo disclosing only the information that would be prejudicial to the entity's position. In those circumstances, an entity shall disclose the fact that, and the reason why, the information has not been disclosed. In no circumstance may an entity forgo disclosing the amount of the claim or assessment against the entity (or, if there is no claim amount, an estimate of the entity's maximum exposure to loss); providing a description of the loss contingency, including how it arose, its legal or contractual basis, its current status, and the anticipated timing of its resolution; and providing a description of the factors that are likely to affect the ultimate outcome of the contingency along with the potential impact on the outcome.

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 agree with the Board's decision to exclude the word *extremely* from its description of the circumstances under which the prejudicial exemption may be exercised. We recommend that the word *rare* also be deleted from paragraph 11. As stated in our response to question 8, we do not think that the circumstances in which the required disclosures might be prejudicial would be "rare." It will be very difficult for management and their legal counsel to support their assertion that certain information meets the "rare" criterion and therefore should not be disclosed. Auditors, in turn, will need supporting evidence to substantiate that assertion. Support for such an assertion will require more interaction between the company, its legal counsel, and the auditors, which will take time and therefore increase costs.

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?

We agree.

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 generally support requiring disclosures about loss contingencies in both interim and annual reporting periods, which are similar to the disclosures that are required under APB 28, Interim Financial Reporting, paragraph 22 (which essentially stipulates that contingency disclosures be repeated in interim and annual reports until the contingency has been resolved), as well as consistent with guidance for SEC registrants in Regulation S-X, Rule 10-01. However, we believe the tabular reconciliation should be provided only for annual reporting periods, since we question whether financial statement users receive sufficient incremental benefit from providing the tabular reconciliation during interim periods. We note that the annual reconciliation requirement is consistent with the requirements in both FASB Interpretation No. 48, Accounting for Uncertainty in Taxes, and SOP 94-5, Disclosures of Certain Matters in the Financial Statements of Insurance Enterprises.

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?

Although we do not believe that a case for change has been made, if the FASB believes that, upon further research, there is adequate evidence to support the need for enhanced disclosures, we recommend it consider a package of disclosures that focuses more on descriptive, factual information that is already a matter of public record about a company's loss contingencies. More thorough disclosure of facts about a contingency may provide meaningful information to investors and thus enable them to assess in greater detail the magnitude of the contingency, as well as the potential timing of the contingency's resolution. We believe that our recommended changes to the prejudicial exemption provided in question 9 should also apply.

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 believe that the proposal's effective date needs to be delayed. We urge the FASB to further study this matter. In making the case for change, the Board and its constituents need to be confident that the proposed disclosures will improve the relevance and reliability of financial reporting and that the FASB's goal of better informing financial statement users is balanced against the challenges of developing and presenting that information in today's legal environment. Such a reconsideration would be difficult to complete in time for mandatory application of the proposal in companies' 2008 financial statements.

Also, if the FASB moves forward with the current proposal, we believe it would be impracticable for companies to change the controls and processes necessary, and for the treaty to be amended, to meet the requirements related to these disclosures of loss contingencies in their 2008 annual financial statements. We recommend that the FASB consider the length of time it will take for these changes to occur and delay any proposal's effective date accordingly. We would expect that it would take at least a year.

Appendix B - Editorial Changes:

FASB Proposed Statement of Financial Accounting Standards, Disclosure of Certain Loss Contingencies – an amendment of FASB Statements No. 5 and 141(R)

If the Board were to proceed with a final standard, we recommend the following editorial changes be made and that the FASB consider our request for clarification indicated below while drafting the final standard:

Paragraph 3:

- We believe that additional FASB pronouncements, aside from those presented in Appendix B of the proposal, may need to be amended to indicate whether such loss contingencies are included in the scope of the proposed Statement. For example, the following standards contain references to items that are accounted for as loss contingencies under FASB Statement No. 5, but are not listed in Appendix B:
 - o FASB Statement No. 43, Accounting for Compensated Absences (paragraph 1)
 - o FASB Statement No. 48, Revenue Recognition When Right of Return Exists (paragraph 7),
 - o FASB Statement No. 71, Accounting for the Effects of Certain Types of Regulation (paragraphs 38 and 45)
- FIN 48 amended FAS 5 to delete its references to taxes and made clear that FIN 48 is the source of guidance in accounting for uncertainty in income taxes. By its terms, FIN 48 only applies to income taxes; it does not apply to taxes such as value added taxes, sales and use taxes, property taxes, gross receipt taxes, production taxes, duties, excises, and payroll or social taxes. While preparers generally apply FAS 5 to such tax matters, it is not explicit whether this is appropriate. There are also views in practice that suggest that uncertainty relating to taxes is not considered a loss contingency, but rather should be accounted for under a benefit or asset recognition model. Similarly, even if considered a contingency, there may be a view that the gain contingency guidance, rather than the loss contingency guidance, of FAS 5 applies. Accordingly, we suggest clarification as to whether, and to what extent, non-income based taxes are scoped into the proposed standard. This question is also relevant because the proposed standard applies to contingencies under FAS 141(R), which also requires clarifying guidance as to its application to non-income based tax uncertainties.

If taxes are scoped into the proposal, we suggest clarification as to whether, and to what extent, detection risk should be considered in applying the standard. The emphasis of the proposed standard on cash outflows might suggest detection risk would be considered, as it can have a significant impact on management's expectations with respect to cash payments. Under FIN 48, detection risk is effectively prohibited from being considered in the application of its recognition and measurement principles. On the other hand, it is understood to be an appropriate consideration for purposes of applying the liability classification and early warning disclosure guidance of FIN 48.

Finally, if taxes are scoped into the proposed standard, we suggest the Board consider inclusion of an administrative practices and precedents accommodation similar to that provided in FIN 48. We believe that the factors that led to the Board's decision to provide the accommodation in FIN 48 would be equally applicable in the context of non-income based taxes.

- We request that the Board clarify whether product warranties and product defects are within the scope of the proposed standard. Obligations related to product warranties and product defects are specifically included and cited as an example of a loss contingency under FAS 5 (paragraph 4b). However, specific disclosure requirements for product warranties are required by paragraph 14 of FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN 45). Because disclosures for product warranties are included in FIN 45 and the proposal excludes from its scope guarantees within the scope of the disclosure requirements in FIN 45, we raise the question as to whether disclosures for product warranties and product defects are excluded from the scope of the proposal.
- As written, the scope exceptions provided in paragraphs 3.c. and 3.d. could be misinterpreted to be narrower than what we believe the FASB intended. As written, one could interpret the scope exception in paragraph 3.c. to apply only to liabilities for unpaid claim costs, and in paragraph 3.d. to apply only to liabilities for insurance-related assessments. We believe the FASB intended the scope exception to be more expansive to address all contingent liabilities relating to insurance and reinsurance contracts (e.g., the unearned premium liability on a short-duration contract). We also note that unpaid claim costs may involve definite liabilities that have no remaining contingency (i.e., the contingent event has occurred even if the ultimate claim cost is not yet known). Therefore, we suggest the following modifications to paragraphs 3.c. and 3.d.
 - 3.c. <u>Contingent Lliabilities for unpaid claim costs</u> related to insurance contracts or reinsurance contracts of an insurance entity or a reinsurance entity (e.g., unpaid claim costs) within the scope...
 - 3.d. Contingent Lliabilities for insurance-related assessments within the scope...
- We recommend that the FASB clarify whether materiality should be assessed based on the claim amount or maximum exposure to loss amount, or an entity's best estimate of possible loss. For example, would companies be required to disclose cases where the maximum exposure to loss amount is material, but history shows that such cases settle for immaterial amounts? We also recommend clarification as to whether materiality should be assessed for each loss contingency individually or in the aggregate.
- In addition, we recommend clarification in the final standard that the underlying premise to the proposal that a maximum exposure to loss can be estimated for all loss contingencies would not negate the second criterion for recognition in FAS 5, which is that a loss contingency be reasonably estimable. That is, please confirm that the Board does not intend to change the recognition criteria for loss contingencies under FAS 5 at this time.

Paragraph 8:

- If a loss contingency were to become a definite liability, would it be excluded from the tabular reconciliation at that time? Assume, for example, a litigation claim that was originally reported in the tabular reconciliation for \$200 million and was subsequently settled for that amount to be paid in 20 annual installments of \$10 million. It is our belief that, upon settlement, this should be removed from the reconciliation, since the amount would no longer be uncertain, but a liability would still exist.
- We understand that under the proposal if a loss contingency arose for a public company in the first quarter but was settled in the third quarter, the company would have to disclose it in the first- and third-quarter tabular reconciliations. For the annual tabular reconciliation, would the company (1) exclude such activity, since the loss contingency arose and was settled in the same annual period, or (2) include the activity, since the company already disclosed it in the quarterly financial statements? Depending on the answer, disclosure requirements might be different for companies that are not required to issue quarterly financial statements (e.g., private companies) than for public companies. We believe that such activity should remain in the annual filing since it has been disclosed in the quarterly financial statements.
- We request clarification on applying the prejudicial exemption to the tabular reconciliation. By utilizing the prejudicial exemption, does a company exempt itself from disclosing a tabular reconciliation in its entirety, or does it exempt itself only from disclosing the prejudicial information? If the latter is true, the table might be a meaningless addition to the financial statements, since it would omit significant (prejudicial) loss contingencies. Also, if the population of recognized loss contingencies is incomplete, the beginning and ending balances of the reconciliation would not agree with the balance sheet. If the table omits significant prejudicial loss contingencies, we believe that disclosure of the remaining loss contingencies in the table that were not subject to the prejudicial exemption should be disclosed if those remaining loss contingencies are material. However, if the remaining loss contingencies are not material, a tabular reconciliation would not be beneficial to investors in understanding the likelihood, timing, and amount of future cash flows associated with loss contingencies.
- It is not clear in which column of the tabular reconciliation a company should record contingencies acquired in a business combination that were not recognized on the acquisition date and instead were recognized under FAS 5 in the postcombination period. Should the company record those contingencies in (1) the column of items accounted for in accordance with FAS 5, because the acquired contingencies have been recognized and measured under FAS 5, or (2) the column of items accounted for in accordance with FAS 141(R) because the contingencies were acquired in a business combination? It is our belief that such disclosure should be provided in the column of items under FAS 5 to avoid mixed recognition and measurement in the column for contingencies acquired in a business combination.

Paragraph 10:

We suggest the language in paragraph 10 be updated as follows to include similar language as the amended paragraph on subsequent events in FAS 5 detailed in Appendix B, paragraph B1.c.11.

10. After the date of an entity's financial statements but before those financial statements are issued, information may become available indicating that a liability was incurred loss contingency arose after the date of the financial statements or that it is more than remote that a liability loss contingency was incurred after that date. In those situations, if disclosure is necessary to keep the financial statements from being misleading, an entity shall provide only the disclosures required in paragraph 7 that would achieve this objective ...

Without the recommended additional language, one might read the disclosure requirements and assume such disclosure should apply to any liability incurred after the date of the financial statements, which does not appear to be the intent of the FASB. Additionally, please clarify whether the Board intends to require all disclosures in paragraph 7 for subsequent events. This may not leave management and their legal counsel with adequate time to assess the details of the loss contingency in which to prepare the financial statements in a timely manner.

Paragraph A8:

This paragraph, as worded, could be interpreted to mean that all loss contingency accounting for insurance and reinsurance entities should be outside the scope of the proposal. However, we believe the FASB intends to require insurance and reinsurance entities to follow the proposal for certain types of loss contingencies, such as litigation related loss contingencies. Therefore, we recommend the following changes to paragraph A8:

A8. The Board does not intend to change the accounting and disclosure requirements for insurance and reinsurance contracts and insurance-related assessments for insurance and reinsurance entities in this project. Accordingly, contingent liabilities for unpaid claim eosts-related to insurance contracts or reinsurance contracts and for insurance-related assessments of an insurance entity or a reinsurance entity are outside the scope of this proposed Statement. However, the existing disclosure requirements of Statement 5 apply in certain circumstances, as required by AICPA Statement of Position 94-5, Disclosures of Certain Matters in the Financial Statements of Insurance Enterprises. This Statement amends that SOP to include within its body the existing Statement 5 disclosure requirements. Similarly, liabilities for insurance-related assessments also are outside the project's scope; thus, AICPA Statement of Position 97-3, Accounting by Insurance and Other Enterprises for Insurance-Related Assessments, also is being amended to reflect the existing Statement 5 disclosure requirements, rather than the requirements in this proposed Statement.

Paragraph A9:

The confirmation that "loss contingencies that are self-insured" are in the scope of FAS 5 and the proposal may cause confusion. We believe loss contingencies within the scope of the proposal remain within the scope whether insured or not. We recommend the following changes.

...Additionally, loss contingencies, whether insured or that are self-insured, are in the scope of Statement 5 and, therefore, also would be in the scope of this proposed Statement.