

FASB Invitation to Comment
Disclosure of Certain Loss Contingencies
The Ohio Society of CPAs Accounting and Auditing Committee



August 7, 2008

LETTER OF COMMENT NO. 185

Financial Accounting Standards Board
Attn: Technical Director— File Reference No. 1600-100
401 Merritt 7
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To: director@fasb.org, File Reference No. 1600-100

Dear Technical Director, Board members and Staff,

The Accounting and Auditing Committee of The Ohio Society of CPAs is pleased to respond to the FASB's invitation to comment on the proposed standard "*Disclosure for Certain Loss Contingencies, an amendment of FASB Statement No. 5 and 141(R)*".

In summary, our feedback includes:

- The proposed draft seeks to expand disclosures not meaningful to financial statement users with detail and estimate information for contingencies not likely to significantly impact organizations. We believe contingency disclosure criteria existing in the current Standard No. 5 are adequate.
- The option to waive information deemed prejudicial to the Entity (in the evaluation and resolution process on a contingency) is absolutely necessary, and is not adequately dealt with in this standard. The "aggregation" approach proposed in the standard will only have effective value to the very largest of organizations, and is inadequate for the majority of organizations impacted by this proposed standard. Waiving disclosure detail will be the only option available to a majority of Entities, which this proposed standard references to as "rare occurrences". We believe such waiver on prejudicial contingency disclosures will by necessity be common, not rare. We strongly believe this proposed standard should be modified to expand the waived disclosure option when potential prejudicial harm potentially exists.
- We also have practical concerns on: (1) the timing and effective application of this standard, especially in the area of subsequent event disclosure requirements (which are imposed up to the date of the issuance of an auditor's report) and (2)

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the need to effectively renegotiate the “treaty” in effect on legal letters between the AICPA and American Bar Association as a result of this new standard.

The following text outlines the questions posed by the FASB and our feedback to these questions on the proposed accounting standard.

- 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?*

Overall, we believe existing Statement of Financial Accounting Standard (SFAS) No. 5 guidance is adequate, and this draft standard greatly expands incremental disclosures (and the work associated with preparing and auditing them) without any significant benefit to users of financial statements.

This proposed standard seeks to improve practice application deficiencies seen in Paragraph 10 of SFAS No. 5, with disclosures associated with contingencies having a “reasonable possibility” of loss”. The Draft text expresses concern that frequent assertions of inability to estimate loss in these instances deprive users of beneficial disclosure information. We believe this problem stems from inherent limitations posed by legal contingencies rather than disregard for accounting standard implementation.

Existing criteria under SFAS No. 5, paragraph 8, calls for loss recognition where it is probable (through impairment of an asset or incurrence of a liability) and it can be reasonably estimated as of the date of the financial statements. Under SFAS No. 5, paragraph 10, where a contingent loss is deemed reasonably possible but not probable or where a loss cannot be reasonably estimated, disclosure is called for as to the nature, range of potential loss beyond that recognized in the financial statements. Where no claim or assessment has been manifested, no disclosure is required unless it is deemed probable that a claim will be asserted and there is a reasonable possibility that the outcome will not be favorable.

In the normal course of business, contingent loss issues arise from a variety of potential areas including but not limited to product liability or related recall issues, from litigation, as well various other assertions made periodically from tax authorities and other agencies. Many such assertions may take time to resolve, and in many instances, the loss to an organization may be relatively minor or non-existent in its final resolution.

This proposed standard would expand contingency disclosures to encompass many issues not deemed remote. The end result would catalog many potential contingency

issues that may arise, regardless of their potential impact on the Entity. Any contingent loss with reasonable possibility of occurrence and significant potential effect should be subject to accrual consideration and disclosures. However, we do not believe financial statement users benefit by disclosures on issues that in the long term are not likely to significantly impact the Entity.

Reliable loss estimation on contingency issues is by nature difficult because it includes many aspects that depend on future events and evolving legal evaluation and other dialogues to ultimately resolve. Where such contingency issues have a relatively large range of loss, it may be reasonable to disclose how financial statement recognition compares to that loss range, presuming detailed disclosures do not prejudice any legal process where such issues are being arbitrated or litigated.

Paragraph 12 of SFAS No. 5 presents several instances where contingencies, that are characteristic of guarantees provided by an Entity, require footnote disclosure. We concur with continued inclusion of such disclosures in financial statements.

- 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 concur with inclusion of withdrawal liabilities in this standard, as they are contingencies that impact cash flow and should be covered by the standard.

As further standards are developed and refined on pensions, we believe specific inclusion of this issue within those standards should be given consideration in order to consolidate overall guidance on pensions in accounting standards.

- 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 believe disclosures on contingencies should be limited only to those issues that have a reasonable possibility of occurrence of loss for the organization and where such loss may have a significant financial impact. Any contingency deemed insignificant or where likelihood of loss impact on the organization is deemed remote should be eliminated from any disclosure requirements

- 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?*

We do not concur with the approach of requiring an assessment of a contingent loss, even if there is no evidence a claim is made. This is highly speculative, prejudicial, and difficult to audit without compromising attorney/client confidentiality. Relying on the prejudicial exception is difficult here as such an exception is supposed to be a rare occurrence per this proposed standard.

Even when there is evidence of a claim made, initial claims typically start with a "maximum" assertion that often is unrealistic in terms of the actual potential loss to the organization. Resolution of such assertions typically involves a lengthy process of comparing facts and perspectives from legal, or other regulatory references, with considerable latitude for negotiation over time.

We strongly suggest enforced disclosure of an Entity's "estimated or potential position" in how to resolve such an assertion is detrimental in such a process. It is not clear in many of these instances, how this quantification and disclosure will work in practice. We suspect many organizations will view such detailed disclosures as prejudicial. It is not clear "aggregation" will provide a solution to this concern; we believe a common approach in practice will be to forgo elements of disclosure deemed prejudicial.

- 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 concur with disclosure of a loss range, where applicable, for contingency issues deemed to have: (1) reasonable possibility of loss to the Entity, (2) such estimated loss is significant in impact on the Entity, and (3) there is a relatively large potential range of loss involved. Inclusion of any loss range in a disclosure should be optional based on the Entity's evaluation of the facts and estimated exposure underlying each claim.

- 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 only contingent loss exposures deemed to have (1) reasonable possibility of loss and (2) which are significant in potential impact, should be considered in any disclosure requirements, and that the option to forgo prejudicial disclosures should be permitted in a broad fashion, not as a rare occurrence.

While the absolute amount of any legally asserted claim for such instances may be cited, the Entity should be permitted to forgo any detailed disclosures as deemed necessary to avoid prejudicial harm to their resolution efforts in the issues involved.

- 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 many “reasonably possible” contingencies, particularly those with legal implications, will pose challenges in projecting reliably meaningful views of possible range of loss that might be realized at some future point. This threshold will encompass lower probability contingent issues that by nature are difficult to reliably estimate.

The higher the likelihood of loss exists, the more likely it is there will be more information available on which both to estimate any loss and to disclose meaningful information to financial statement users on the potential effect of such loss 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 don't believe disclosing legal offer and counter-offer information is meaningful. The nature of this resolution process often results in extended interactions between litigating parties. The cost of litigation, as well as other factors, is often key variables that may influence ultimate resolution. We believe the most relevant information is management's best estimate of loss exposure, with permitted modified disclosure where these may be prejudicial to the ongoing resolution process.

- 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?*

For contingencies involving probable loss for a company, the tabular reconciliation will provide a highlight on changes during a period to a reader of the financial statements. The main issue will be those instances where detailed disclosure information may be prejudicial to the entity involved. An example can highlight this issue:

A company has a single loss contingent issue. In severing a distributor relationship, the customer refuses to pay amounts owed on past sales (Accounts Receivable). The Entity sues for collection of monies owed, and is in turn sued by the customer for "damages" from alleged oral commitment violations. In review with legal counsel, the Entity believes the facts and issues will support successful litigation for ultimate collection of monies owed and legal determination that no wrong was done to the customer. This is a typical lawsuit incurred in the normal course of a trade or business.

Is there a contingent loss issue involved here? The Entity believes the facts will eventually render it successful in defending against the customer assertions. However, some length of time and legal expense will be incurred to obtain final resolution and eventual recovery of legal expenses incurred may be problematic in the eventual outcome. In its' evaluations, the Entity concludes that if a settlement opportunity at a nominal amount (i.e. a fractional amount of the Receivables withheld) presents itself in the course of this resolution, it would likely choose to incur some loss to avoid lengthy legal effort. Based on this determination, it accrues the nominal settlement amount as a recognized loss in its financial results. The loss recognized is not material to the overall financial statements.

- How would disclosures of this issue be handled under this proposed Draft? Given the fact this is the single lawsuit in motion for the Entity, "aggregation" to avoid prejudicial harm in disclosures is not an option.
- Is the amount the Company might choose voluntarily to "settle at" a contingent loss?
- Is a contingent loss probable, more than likely, reasonably possible, or remote under these circumstances?
- Should the loss be accrued (i.e., the nominal settlement amount) and subjected to tabular format disclosure, and if so, what incremental disclosure should be made?

This conceptual example demonstrates how evaluations might occur in the context of lawsuits. In practical application, the tabular disclosures will likely bear the same issues surrounding concerns about the impact of prejudicial harm from such disclosures.

We believe tabular disclosures should be provided in an aggregated manner and should only be prepared in instances where the relative impact of such contingent loss accruals is large relative to the Entity's financial statements. Such disclosures in a tabular format should not be required, unless such loss accruals exceed a significant threshold (i.e., contingent loss accruals exceed 5% or more of the Entity's assets as reported on its financial statements).

- 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?*

We are in absolute agreement with the exemption from disclosing prejudicial information. With contingent issues, particularly where legal assertions and related litigation may be involved, the nature of the process involves a lengthy period of time where fact gathering, interpretation and legal posturing are taking place. Many considerations may be involved in determining the approach and the potential for settlement that may be taken by an Entity in reaching final resolution. Detailed disclosures in the early stages of this process, where the loss exposure is of a contingent nature, would unfairly disclose internal evaluations, which could provide unfair advantage to the other parties involved in the contingency issue.

We also note the International Accounting Standards Board has separate accounting standards that apply to private entities and for public entities, that enable it to achieve a more flexible application of requirements. No such capability currently exists via the FASB in the standard setting process in the United States, where a "one size fits all" mentality permeates our accounting standards. Therefore, the perception of "rare" with regards to the prejudicial exception concept has very different implications in our environment.

- 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?*

Only the largest of Entities will be able to effectively use an "aggregation" approach to overcome issues relating to disclosures that might prejudice ongoing processes to resolve assertions.

For the majority of Entities impacted by this standard, the only recourse to avoid prejudicially damaging detailed disclosure will be to forgo those disclosures and disclose that judgment. The term "rare" is used to describe these instances. We believe in the real world of most Entities involved in litigation and related assertions, the applicable word is "common", less this accounting standard is written to apply to only the very large entities (i.e., the "large accelerated filer" definition used by the SEC).

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?*

No, we do not agree with the use of the term "rare" or "extremely rare". Only the very largest of entities will be able to effectively use an "aggregation" approach to overcome issues relating to disclosures that might prejudice their ongoing processes to resolve assertions.

For the majority of Entities impacted by this standard, the only recourse to avoid prejudicially damaging detailed disclosure will be to forgo those disclosures and indicate so. The term "rare" is used to describe these instances. For most Entities involved in litigation and related assertions, the applicable word is "common", unless this accounting standard is written to apply to only the very large (i.e., the Fortune 500 companies) entities.

As noted in our response in Question 8 above, we also believe the standard setting process (for private entities) used by the International Accounting Standards Board enables it to apply narrower applications to private entities than it would in the United States. The use of a "one size fits all" approach by the FASB stands in contrast and most likely will encounter practical application issues for most smaller entities, whether public or private.

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 concur with the description of prejudicial information.

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?*

As outlined in our response to Question 7, we believe any tabular disclosures should be limited only to significant contingent loss issues.

Assuming such an approach were taken, we believe any tabular reconciliation format used should be required only on an annual basis, with any interim disclosures limited to significant events or changes occurring during that interim period.

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?

There is no additional information we would recommend for disclosure that is not dealt with in the proposed accounting standard.

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?

Practical application of this proposed standard, as written, would require significant efforts for both statement preparers as well as auditors in its implementation. As written, the initial implementation would occur on the first annual report for the fiscal year ending after December 15, 2008 and then be updated in subsequent interim and periods thereafter.

In addition, there is a need for the "treaty" regarding the responses to legal letters between the AICPA and the ABA (American Bar Association) to be renegotiated as a result of this new standard. This should be done prior to any implementation of this new standard and this action has significant operational impact on the application of this accounting standard and the effective date.

We note the proposed accounting standard calls for subsequent events to be disclosed (even if they are type 2 events) up to the date of issuance of an auditor's report. This creates practical issues with the dating of the auditor's report. We believe additional consideration should be given to modifying or eliminating the provisions dealing with subsequent events to better support practical application of this accounting standard.

We don't believe imposing this Standard for fiscal years ending after December 15, 2008 is realistic. This proposed standard has a proposed comment date in August 2008, and likely would not become a final standard until later in 2008, at best. Any such implementation should be at a minimum for fiscal years ending after December 15, 2009. We believe the initial implementation should commence with the first annual report after that date, and any detailed disclosures should be updated on an annual basis. Any interim disclosures should be limited to updating for any material event(s) occurring during such periods, for financial statement users from the last annual report.

We appreciate the opportunity to comment on this proposed standard, and welcome any additional opportunity to further discuss or otherwise support the efforts of the FASB in this area.

Best Regards,

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