

August 8, 2008

Via email



LETTER OF COMMENT NO. 186

Technical Director
Financial Accounting Standards Board
File Reference No. 1600-100
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Invitation to Comment - Proposed Statement of Financial
Accounting Standards, *Disclosure of Certain Loss Contingencies*,
an amendment of FASB Statements No. 5 and 141(R)

Wells Fargo & Company (Wells Fargo) is a diversified financial services company with over \$609 billion in assets providing banking, insurance, investments, mortgage and consumer finance services. We appreciate the opportunity to comment on the issues being considered by the Board to enhance the disclosure requirements in FASB Statement No. 5, *Accounting for Contingencies*, (FAS 5) for loss contingencies that are recognized in a statement of financial position and for unrecognized loss contingencies that would be recognized as liabilities if the criteria for recognition in paragraph 8 of FAS 5 were met.

We believe that the proposed amendment to FAS 5 will change the existing standard in significant ways and raises significant concerns. We are particularly concerned that the Board is revising required disclosures relating to such a fundamental accounting standard without working more closely with the International Accounting Standards Board (IASB) to ensure that both Boards are working toward a common and consistent accounting standard for loss contingency accounting and disclosures. Convergence is a high priority on the agendas of both the U.S. Financial Accounting Standards Board and the IASB. Important differences currently exist between the relevant accounting standards in this area in the U.S. and internationally, including the fundamental concept of the definition of "probability" (under U.S. generally accepted accounting principles, probable is interpreted as likely while under international financial reporting standards, it is interpreted as more likely than not, a lower standard than in the U.S.). We observe that this fundamental difference is not addressed in the exposure draft, which is focused on expanding disclosures which are currently not included in international financial reporting standards. With the Securities and Exchange Commission's (SEC) goal to allow U.S.

companies to switch to international accounting standards potentially as early as 2011, we think it is extremely important that any amendment to this standard resolve all differences between generally accepted accounting principles and international financial reporting standards. Failure to do so will result in companies implementing new U.S. generally accepted accounting principles related to loss contingencies in 2008, then again at the time of convergence to international financial reporting standards which could be as early as 2011. In addition, we want to remind the Board of the extreme difficulties which were ultimately worked out between the accounting and legal professions in order for them to both comply with the existing FAS 5 requirements. This onerous and lengthy process will have to be repeated given the expanded disclosures being contemplated by the Board. We do not believe issuing an amendment to FAS 5 that only expands disclosures to be a high priority for the Board. Such an amendment is not consistent with the Board's (and SEC's) stated goal of avoiding multiple changes of the same accounting standard as we ride two horses toward high-quality converged international accounting standards. We believe that it would be beneficial and efficient for the FASB and the IASB to work together on a single standard to fully converge both the accounting and disclosure rules dealing with loss contingencies.

We have specific concerns with the proposed expanded disclosure requirements as follows:

- **We believe that the proposed change creates significant cost with little benefit.** The Request for Comments seeks information about whether the benefits of enhanced disclosures justify the incremental costs. We believe that the most significant costs have not been properly considered. The amendments actually encourage litigants to claim very large damages when filing lawsuits in order to gain leverage for larger settlements from public companies. Since it is difficult to determine that any loss is "remote", companies will be required to report the amount claimed, including any treble or punitive damages. While it is true that the amount of a claim is often, but not always, contained in public documents, it does not follow that disclosure of an asserted claim would not be prejudicial. Many public companies are subject to frivolous lawsuits seeking huge damages unrelated to any actual injury. For example, a litigant may claim that a bank improperly honored a \$100 check, resulting in significant emotional distress, consequential and punitive damages totaling \$100,000,000. (Unfortunately, such claims are not uncommon.) If the bank assumes that a contingent loss of \$100 is reasonably possible, it must, under the exposure draft, disclose in public documents a claim against it of \$100,000,000. Such disclosure provides no useful information for users of financial statements and is much more likely to mislead rather than enlighten investors. On the other hand, it provides a significant benefit to the plaintiff. In the current example, the bank would follow the provisions of the exposure draft and disclose its best estimate of the possible range of loss because the amount claimed is not representative of the bank's exposure. This only benefits the plaintiff. Assume the bank determines that it could pay up to \$50,000 of additional damages, even though it believes its exposure should only be \$100. The statement of a range raises the plaintiff's hopes for settlement and makes it unlikely that the case would settle for \$100. Of course, the bank may decide not to settle

for more than \$100, but then it will have to incur more in legal expenses because the plaintiff might push the case longer in hopes of a larger settlement or for the chance to tell a jury that the bank thought the case could cost \$50,000. The result of the disclosure policies of the exposure draft in this example would not provide any benefit to users of financial statements, but would only give the litigant a weapon against the bank, substantially increasing the incentive for the bank to settle a spurious claim. Furthermore, transactional and litigation costs would increase with no benefit to the bank or its shareholders.

- **Litigants would manipulate the new disclosure requirements to obtain information on what cases might be worth.** Most large class actions are filed without any specific claim for damages. Under the exposure draft, companies would be required to disclose their “best estimate of the maximum exposure to loss”. This forces a defendant company to quantify and disclose to a plaintiff its potential maximum exposure in a matter for which the claimant may have no idea of the size of its claim. First, this constitutes free discovery for the plaintiffs. Second, and more dangerously, it could directly damage and prejudice the company. The exposure draft requires an estimate of the “maximum exposure to loss”. Just as FAS 5 now recognizes that loss contingencies may be probable, remote, or reasonably possible, most lawsuits have exposure to a range of dollar losses where amounts along that range are probable, remote or reasonably possible. For example, using the example from above, assume a claimant writes a bank asserting a wrongful dishonor of a \$100 check and stating that it will seek substantial, but unspecified damages for emotional distress, and consequential and punitive damages. The bank may believe that the \$100 loss is probable, a \$50,000 loss is reasonably possible, but that there is a remote chance of a \$10,000,000 loss. Under the exposure draft, the bank would have to disclose a loss exposure of \$10,000,000. As above, this disclosure misleads rather than enlightens users of financial statements, and provides the claimant all of the wrong incentives, resulting in increased costs to the bank. The larger the exposure, the more willing the claimant would be to devote substantial resources to the case. Anyone familiar with litigation practices over the last several years understands that one lawsuit begets other “copy-cat” lawsuits, as litigants position themselves to fight over the hoped-for bounty of significant litigation. The FASB is asking public companies to advertise their maximum exposures in their financial statements, available to those who seek to harm those companies. We also note our view of the ineffectiveness of the Board’s proposal to deal with the prejudice resulting from disclosure by allowing the company to aggregate its disclosures by the nature of the loss contingency. For most companies, a subset of cases or a single unique case pose a much greater threat of loss than others and sophisticated litigants will use the company’s financial statements to decipher those cases from others in the aggregate disclosures. In addition, statements of aggregate numbers of maximum, but remote, exposure for large public companies will be enormous and significantly misleading to the public. We are also concerned with the requirement to include a tabular reconciliation of recognized loss contingencies, along with a qualitative description of the significant activity in the reconciliation. Plaintiffs

who are intimately familiar with the status of their litigation will easily be able to use this disclosure to gain an unfair insight into the company's strategy.

- **The exposure draft does not adequately address materiality issues and, if not rejected, must be amended to ensure that immaterial loss contingencies are not misleadingly disclosed as material.** The exposure draft provides that it need not be applied to immaterial items. However, the structure of the disclosure requirements will result in the misleading disclosure of immaterial items. Most claims brought against large public companies fail. Companies prevail much of the time or settle claims for small amounts. As discussed above, virtually all litigation can result in a range of loss, for which the amount of any particular loss can be considered probable, remote or reasonably possible. Accordingly, the disclosure currently required under paragraph 5 of the exposure draft is for all claims that would be of a material nature unless it is determined that the risk of any loss is remote. To use the example from above again, if someone claims \$100,000,000 in damages for the dishonor of a \$100 check, the bank would have to disclose the \$100,000,000 claim unless it determines that the chance of recovery of the \$100 is remote. This justifies not requiring any disclosure. However, if the FASB determines that it wants to increase disclosure, it should consider limiting the disclosure required by paragraph 5 with a paragraph 5(c): "Disclosure is not required for a loss contingency for which the entity has made an assessment and determined that its best estimate of the reasonably possible loss or range of loss is immaterial." Similarly, the paragraph 7(a) (2) requirement of estimating the maximum exposure to loss when no claim is asserted should be amended to provide as follows: "If there is no claim or assessment amount, the entity's best estimate of the reasonably possible maximum exposure to loss." Finally, the last sentence of paragraph 7(a) should be similarly amended: "An entity also may disclose its best estimate or the reasonably possible loss or range of loss"
- **We do not agree that current standards do not provide sufficient information to assist users of financial statements in assessing the likelihood, timing, and amount of future cash flows associated with loss contingencies.** If companies believe that they will have a material loss, they are already required to provide information about the loss as early as possible when reliable information first becomes available, which usually is when a reserve is recorded. We note that assessments of pending litigation are inevitably uncertain and subject to factors outside the control or ability to foresee of any of the involved parties. As a result, the required disclosures, should they be made prematurely and prove inaccurate, which some certainly will, would not provide information useful to financial statement users making economic decisions and in fact may be sources of additional claims and securities litigation against the company. At the very minimum, the new disclosures, particularly those involving loss estimates, would constitute admissible evidence against the company in the litigation or alter the outcome of the litigation by changing the course of settlement discussions.
- **The proposed disclosures may lead to waivers of the attorney/client privilege and the confidentiality of an attorney's work product.** The required disclosures will

obviously be developed with significant input from the attorneys handling the litigation. Disclosure of the information could result in judicial findings of waiver of the attorney/client privilege or of the confidentiality of an attorney's work product that would otherwise protect such assessments from discovery or from use against the company in litigation. Additionally, as independent auditors will certainly want to test the information included in the new disclosures as part of their audit work, there will be increased pressure for them to seek detailed information from counsel in the course of their work further weakening the privileged nature of this information.

- **The proposed requirement to disclose loss contingencies with near-term severe impact, even if the risk of loss is remote, exacerbates the problems caused by the exposure draft.** Matters that are "less than catastrophic" but could cause a "significant financially disruptive effect on normal functioning" must be disclosed even when the risk of loss is remote. This motivates litigants to claim huge damages, even in completely frivolous cases, because they will know that the amount sought will require public disclosure close to final resolution of a case, a very sensitive time in the litigation life cycle, yet another opportunity for manipulation of the disclosure rules for litigation ends.
- **The cost and burden of providing the "qualitative information" required by the exposure draft will be substantial.** For companies with a large number of litigation matters, significant time and resources will be expended developing the new qualitative and quantitative disclosures, including "a description of the factors that are likely to affect the ultimate outcome of the contingency along with their potential effect on the outcome; the entity's qualitative assessment of the most likely outcome of the contingency; and significant assumptions made by the entity in estimating the amounts disclosed". Additionally, this would have the impact of devoting additional resources from a Sarbanes-Oxley 404 perspective to document and test the new process related to the qualitative and quantitative disclosures. We do not think this will be a productive use of resources and not useful to the investing public.
- **The proposed guidance regarding subsequent events is not feasible.** The requirement for disclosure arising from information that becomes available after the date of an entity's financial statements but before those financial statements are issued creates another significant opportunity for manipulation. For example, litigants may be more likely to assert claims for prior acts right before issuance, hoping that timing constraints will cause companies to say too much or to word matters incorrectly. This specific proposal gives a very precise weapon to litigants who can time the provision of information. In addition, for entities with a large number of litigation matters, the likelihood of subsequent events is high and the time required to develop these disclosures, clear them with counsel and for the external auditor to audit them will be significant and will probably result in missed filing deadlines and significant printing costs due to large revisions late in the process.
- **It will not be possible for companies to implement the proposed statement in fiscal years ending after December 15, 2008.** For companies with calendar year ends, the

proposed statement would need to be implemented in the current year. We do not believe that implementation this year is a realistic possibility. For companies with a large number of litigation matters, the qualitative and quantitative disclosures, including the new tabular reconciliation of recognized loss contingencies, will require significant time and effort to develop. As noted above, companies will need to work very closely with numerous parties concerning each piece of litigation to carefully craft the disclosures in such a manner as to both meet the new disclosure requirements and try to preserve the privileged nature of the underlying information, assuming that is even possible. This will not be a simple undertaking.

Conclusion

The proposed disclosures go far beyond those currently included in comparable IFRS rules. The IASB has not yet begun to evaluate disclosure requirements for loss contingencies. Rather than issue this amendment now, we encourage the Board to work closely with the IASB to issue a single, fully converged set of rules that address all existing differences in this area. We strongly support continuance of the current FAS 5 standard, especially as it relates to litigation disclosures. We understand the Board's desire to provide users of financial statements with additional information in this judgmental area of accounting. However, we believe that a proper balance has not been set between the needs of financial statement users for this information and the serious problems disclosure of the information creates for financial statement preparers. In our view, the proposed amendment is most effective in supplying weapons to be used against U.S. companies. The proposed amendment will require issuers to harm themselves solely so that they can provide inaccurate and affirmatively misleading information to the investing public.

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We appreciate the opportunity to comment on the issues contained in the Board's invitation. If you have any questions, please contact me at (415) 222-3119.

Sincerely,

/s/ Richard D. Levy

Richard D. Levy
Executive Vice President & Controller

CC: Ms. Donna Fisher, American Bankers Association
Ms. Gail Haas, New York Clearinghouse Corporation