



LETTER OF COMMENT NO. 143

Business Roundtable

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The Financial Accounting Standards Board 407 Merritt 7
P.O. Box 5116
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Re: Disclosure of Certain Loss Contingencies: Amendments to FASB Statements 5 and 141(R); Reference No. 1600-100

Ladies and Gentlemen:

This letter is submitted on behalf of the Business Roundtable, an association of chief executive officers of leading U.S. companies with over \$4.5 trillion in annual revenues and more than ten million employees. Member companies comprise nearly a third of the total value of the U.S. stock market and represent nearly a third of all corporate income taxes paid to the federal government. Roundtable companies give more than \$7 billion each year in combined charitable contributions, representing nearly 60% of total corporate giving. They are technology innovation leaders, with \$86 billion in annual research and development spending — nearly half of the total private R&D spending in the United States.

At the outset, we want to emphasize that Business Roundtable is a strong supporter of the Financial Accounting Standard Board's (FASB) efforts to improve financial reporting to provide investors and other users with timely, accurate and informative financial information. We are writing today to urge you to reconsider the amendments to Statement of Financial Accounting Standards No. 5 and 141(R) that were proposed on June 5, 2008 because we do not believe that they advance the goal. We address our comments to the impact that the proposed changes will have on disclosures of pending and threatened litigation and government proceedings. These changes, if adopted, will involve significant changes in current disclosure practices to the detriment of reporting companies and their shareholders.

Our specific comments on the proposed standard are described in more detail in an appendix to this letter, but several of our more general concerns warrant mention here. First, the requirement for a reporting company to provide quantitative estimates of its maximum possible exposure to loss from a claim may actually affect the course of the

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Johanna I. Schneider Executive Director External Relations proceeding and result in additional litigation if the estimates turn out to be wrong. Second, the required qualitative disclosures risks divulging elements of defense strategy to the opponent in litigation. Third, the process required to produce the mandated disclosures, and the independent auditor's needs to test the information, may seriously compromise the attorney/client and work product privileges. Finally, the disclosure and quantification requirements will significantly increase compliance costs and burdens for reporting companies without a commensurate improvement in the quality of information being provided to investors.

While FASB has said that it proposed the amendments because some investors complained that the existing standard does not provide adequate information. We believe that most reporting companies today conscientiously provide information concerning the progress of their material litigation and government proceedings and quantify the possible exposure promptly when it is known to them with reasonable certainty. Given the many problems raised by the proposed standard, the fact that it represents a major change in practice and goes to the heart of our adversary system of justice, we do not think it should be undertaken without much more deliberation and empirical study.

We therefore suggest that implementation of the proposal should be delayed indefinitely and certainly beyond December 15, 2008. Any reconsideration of FAS 5 should be preceded by an examination of reporting practices relating to contingencies and consultation with all affected constituencies, not only investor groups. In the reasonably near future, the U.S. generally accepted accounting principles are moving toward convergence with international accounting standards. Since such convergence may require further changes, it would be more appropriate for any changes to FAS 5 to be considered as part of that convergence process.

We appreciate the opportunity to present our views and would be pleased to provide any additional information that might be useful in your deliberations.

Yours truly,

ane M. Mulcahy

Chairman & CEO, Xerox Corporation

Business Roundtable, Chairman Corporate Leadership Initiative

CC: Robert H. Herz, Chairman, Financial Accounting Standards Board
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The Honorable Christopher Cox, Chairman, Securities and Exchange Commission
The Honorable Paul S. Atkins, Securities and Exchange Commission
The Honorable Kathleen L. Casey, Securities and Exchange Commission
The Honorable Elisse B. Walter, Securities and Exchange Commission

APPENDIX

The following comments amplify our concerns about the effects of the proposed amendments to FAS 5.

- 1. The reporting requirements of FAS 5 will create an information imbalance between reporting companies and their adversaries in litigation. The United States has an adversary system of justice based on forceful advocacy and vigorous representation by both sides to a dispute. The process proceeds on the basis of well developed and long established rules of pleading, discovery, trial and appeal that are designed to ensure fairness to each party. Additional rules, such as the attorney/client privilege and work product doctrine, have developed to permit counsel to communicate in confidence with their clients to enable them to provide vigorous representation. The FASB's proposal will create an imbalance in information between plaintiffs and reporting company defendants that will be very detrimental to the latter and threatens to undermine the operation of our adversary system of justice. Whenever a reporting company is involved in a legal dispute with an individual or entity such as a foreign company, a government agency or any entity that does not file GAAP financial statements, the reporting company will be required by the proposal to provide and disclose information about its case without receiving or having any means to obtain similar information from the opposing party.
- 2. The requirement that reporting companies quantify exposure to loss first in certain circumstances coupled with the elimination (except in "rare" circumstances) of the exception for amounts that cannot be estimated shifts bargaining power in favor of claimants. Claimants frequently do not quantify claims at the outset of a case because they do not know what the claim is really worth or applicable laws prohibit the statement of a claim amount beyond the required jurisdictional amount and will await discovery or the development of future events to quantify the claim. Government entities also commonly do not quantify possible claims and penalties at the outset of an investigation or proceeding. In many types of cases such as securities class actions, mass tort cases, and anti-trust cases, damages are not asserted until the case develops and the facts are developed. When the reporting defendant is the first party to quantify its likely loss exposure, that act alone may influence the course of the matter by affecting the claimant's ultimate demand, its strategy in pursuing the case, whether additional claims are brought, or its willingness to resolve the claim. At the very least, the reported amount may become a minimum amount in settlement discussions. The amount may also be cited by a claimant as an admission of expected liability by the reporting company. Equally important, this requirement may have the unintended, but perverse consequence of causing claimants routinely to delay quantification of their demands until the matter develops to force the reporting company to speak first. Where a claimant has stated a claim amount, a reporting company may provide its own estimate of possible loss if it does not believe that the claim amount or the maximum exposure is representative of its actual exposure. Reporting companies may feel

pressure to provide their own estimates early as. the plaintiff's demand may be totally unrealistic or the reporting company may be viewed as endorsing the plaintiff's claim as a valid expression of its likely exposure if it merely states the claim amount without response. In either case, the course of the proceeding is likely to be affected and the bargaining power of the reporting company limited by such disclosure.

- 3. The detailed qualitative disclosures that the proposed standard requires raise troubling issues, particularly with respect to the attorney/client and work_product privileges. Most company executives who oversee and are responsible for reporting financial information lack expertise in legal matters. As a result, they frequently rely heavily on the advice of expert advisors, primarily in-house and outside counsel, to assess and plan strategies with respect to pending and threatened litigation and government proceedings. Under the present disclosure regime of FAS 5, companies have developed practices that allow them to give meaningful information to investors and the public about material claims and government proceedings without either engaging in groundless speculation or risking waiver of the attorney/client and work product privileges. The required disclosures under the proposed standard about the likely future course of pending and threatened claims and proceedings, including their timing, most likely outcome, the factors affecting that outcome and the assumptions behind the reporting company's thinking will inevitably require disclosure of detailed information that can best and, in some cases, only be obtained from legal experts in privileged conversations. The proposed standard is therefore likely to lead to more frequent waivers of the attorney/client privilege or to inhibit reporting companies' ability to communicate with the lawyers advising them on claims and government proceedings out of concern that such a waiver could occur.
- 4. The outcome of most contingent claims arising from litigation is highly unpredictable at the early stages of the claim and a requirement to quantify possible losses from such claims too early will often be based on inadequate information and may be misleading. While some types of litigation, such as routine insurance litigation or warranty claims, have a degree of predictability that can be estimated with a reasonable degree of accuracy, many other claims are not so predictable and their possible outcome varies greatly as the litigation progresses. Government investigations and proceedings are even more unpredictable. The factors that affect the outcomes of such matters are so various as to defy cataloging, but most reporting companies have experienced cases where a change in the course of the proceeding, such as an adverse legal ruling, discovery of a new piece of evidence, a change in government personnel or focus, a change in the law, the unavailability of a critical witness, or other matters caused an expected outcome to turn into the opposite. Sometimes, a matter unexpectedly simply goes away. As a result, the two requirements that exposure from claims be quantified very early and that such estimates be amended regularly will give a false impression to readers of the financial statements that there is certainty with respect to the estimates when, in fact, that is often not the case. In many cases, the estimates will turn out to be wrong, not from bad faith or negligence, but simply because the facts change in an unpredictable way.

These "wrong" estimates themselves may become sources of additional, independent claims. Many reporting companies have had experience with cases that have been brought under federal and state securities laws merely when stock prices fell as a result of an unanticipated event or the fact that earnings projections or guidance were not met due to similar events. The requirement to provide detailed projections about the outcomes of claims in cases where potential losses cannot be estimated with reasonable certainty is likely be a fertile source of additional litigation.

- 5. The proposed protection for prejudicial information in the new standard is unclear and will not be effective in many cases. The proposal attempts to address the concern about prejudicial disclosures of information by permitting aggregation of information at a higher level or in "rare" cases, exclusion altogether of the reporting company's qualitative assessment of the most likely outcome of a matter and the reasons for its assessment. In the first place, it is difficult to understand how aggregation could work given the quantitative and qualitative disclosures required under FASB's proposal. The outcomes and magnitudes of the lawsuits being aggregated will likely be very different and turn on very different factors. Either individual discussion of the factors governing each case will be required, defeating the purpose of aggregation, or the discussion of the cases will be at such a level of generality that the disclosure will be meaningless. Even apart from these considerations, while aggregation may in some cases shield information about specific contingent claims where there are a large number of similar claims and the identity of individual matters cannot be readily identified by readers of the information, it is likely to be ineffectual in many cases. Often a reporting company faces one case or group of cases, perhaps an environmental, antitrust, shareholders class action or mass tort claim, that is overwhelmingly consequential compared to other claims. Aggregation will not effectively shield such matters and a sophisticated reader of the financial statements, whether it is a plaintiff's lawyer, an analyst,, a competitor or other person, will be able to discern at least the outlines of the major matter. Under the proposal, in those "rare circumstances" when aggregation at a higher level does not provide protection, the reporting company may forego disclosing the prejudicial information but still must disclose the claim amount, how it arose, its legal or contractual basis and the factors that are likely to affect its ultimate outcome, raising almost all of the problems described above. In addition, it is not clear under the standard who is to be the judge of when such a "rare circumstance" has occurred, but getting that answer wrong is likely to be a source of additional claims.
- 6. Coming up with the information that the proposal demands will be a time-consuming and costly exercise. Inevitably, both management and expert advisors will have to spend time and resources to verify, validate and document the estimates themselves and the assumptions that underlie them and to craft disclosures that meet the requirements of the standard. Many reporting companies will have to develop new systems for estimating likely outcomes of highly uncertain claims that will be costly and will take time to put in place since a reporting company will no longer be able to conclude that its loss exposure cannot be estimated currently. This will be made more difficult by the need to protect confidential communications, not convey strategic information and plans to opponents, and minimize the risks that the information itself will be a source of future claims and proceedings. The new standard's requirement to

update the tabular reconciliation of accruals and the estimates of loss exposure in footnote disclosures in each quarterly or annual financial statement will require the estimation exercise to occur every quarter rather than once yearly as is currently the case and that will significantly increase the cost and effort of compliance. Such effort and expense might be justified if the additional information were truly informative. However, since as discussed above, the information will inevitably be speculative and may well be proved wrong by unpredictable developments, it is not a productive use of resources.

7. The estimates and disclosures required by the new standard will have to be audited by the independent auditor of the reporting company. Since, as described above, management of reporting companies relies heavily on the advice of expert professionals, usually lawyers, to assess strategy and the likely future course of a claim or proceeding, the company's independent auditors are also likely to want to consult with those experts to test management's assertions, especially since those assertions will be greatly expanded under the proposed standard. The existing agreement between attorneys and accountants, known as the "Treaty", relating to the parameters for answers provided by counsel in response to auditor inquiries has been in existence for over thirty years, is widely accepted, and has worked well to protect the interests of investors and the confidentiality of attorney/client communications.¹ The proposed standard may well render that relationship unworkable as auditors feel that they must obtain more information from counsel to audit the more detailed disclosures.

"Inquiry of a Client's Lawyer Concerning Litigation, Claims and Assessments: available at http://www.aicpa.org/download/members/div/auditstd/AU-00337.PDF.

¹ The agreements reached by the American Bar Association and the American Institute of Certified Public Accountants in 1976 governing attorney's answers to auditors inquries is set forth in two documents, "Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information" available at http://www.abanet.org/buslaw/attorneyclient/policies/aicpa.pdf and at AU Section 337.06,