



August 6, 2008

LETTER OF COMMENT NO. 39

Russell G. Golden  
 Technical Director  
 Financial Accounting Standards Board  
 401 Merritt 7 U.S.  
 P.O. Box 5116  
 Norwalk, CT 06856-5116

RE: File Reference No. 1600-100  
Disclosure of Certain Loss Contingencies - an amendment of FASB Statements No. 5 and 141(R)

Dear Mr. Golden:

SAP AG (SAP), a German Corporation listed on the New York Stock Exchange as a Foreign Private Issuer, appreciates the opportunity to provide comments with regard to the FASB's Proposed Statement, *Disclosure of Certain Loss Contingencies - an amendment of FASB Statements No. 5 and 141(R)* (the Exposure Draft). While SAP understands the overall objective of the Board to provide enhanced disclosures about certain loss contingencies to financial statement users, we believe that the proposed changes, in their current form, raise numerous concerns. Any perceived benefits from the proposed changes would, in our view, be minimal as compared to the problems that would be created by adopting the proposal.

The following is a summary of SAP's main concerns with the additional requirements as proposed in the Exposure Draft:

- **Lack of Useful Information to Financial Statement Users:** The proposed required disclosures, particularly for unaccrued contingencies, would largely be based on highly subjective information. In many cases, reliable quantitative information is not available due to the speculation or subjectivity of a plaintiff's damage claim or because the plaintiff has not stated any amount of claimed damages. Financial statement users would be making decisions based on an entity's "best estimate" of what the quantitative and qualitative facts are that surround specific contingencies with such estimates often lacking a reliable basis. Given the unpredictable nature of litigation, the facts and circumstances that would be used to determine these "best estimates" are constantly changing. Thus, only a short time after an estimate has been made, this estimate may not reflect the status of the contingency.
- **Attorney-Client Privilege and Attorney Work-Product Protection Jeopardized:** SFAS No. 5, in its current form, has allowed the balance between attorney-client privilege and useful disclosures in the financial statements of companies to endure for over thirty years. In the normal course of litigation matters, entities have the required disclosures prepared and review by in-house and outside attorneys who are ethically obligated to protect client confidences. Under the proposed disclosure requirements, it will be difficult for attorneys with knowledge of privileged and protected information to prepare and assess such quantitative and qualitative disclosures related to the entity's "maximum exposure" in a lawsuit, the action's "most likely outcome" and factors that affect it, and related "significant assumptions", without drawing on and directly or indirectly revealing the underlying privileged and protected communications from which this information



was derived. If this information were to become public, as it would in a disclosure in public financial statements, it could possibly become admissible during the course of the litigation. An effect of the proposed requirements would be for entities to determine quantitative and qualitative estimates without the expert guidance of counsel in order to avoid risks of waiver of these privileges that the attorney's required disclosure would create. This would only serve to diminish the reliability of the disclosures themselves and thus, provide information that is not useful to financial statement users.

- The Dynamics of the Litigation Process will Change: The information that would be required to be disclosed may, in many cases, reveal an entity's strategy and thinking as to how the litigation will proceed. This will allow the plaintiff the opportunity to reevaluate and change their strategy based on the disclosed information, thus putting the entity at a distinct disadvantage in the litigation. In many instances, plaintiffs will not assign an amount to the claim but rather wait and force the entity to disclose what their "best estimate" is of the potential outcome of the claim. This would unfairly advantage plaintiffs and make it more difficult to fairly resolve litigation. Disclosure of this quantitative and qualitative information can, and will, be used by others not currently involved with litigation with the entity, as a strategy to seek settlements or bring claims against the entity.
- Litigation Arising from the Disclosure Requirements: As a result of the proposed required disclosures, three types of additional litigation could arise. First, the requirement for entities to disclose unaccrued contingencies that are considered to be "near term" and of "serious impact", no matter what the likelihood of loss, indirectly encourages the filing of frivolous suits in an attempt to force entities to settle cases to avoid having to disclose that an extremely remote possibility exists of a "serious impact" loss. Otherwise, entities may be forced to disclose such claims only to have them dismissed in subsequent reporting periods. This would provide financial statement users with unreliable and confusing information and could also have negative consequences to an entity's share value. Second, litigation can arise from financial statement users who have based decisions on the subjective information contained within the disclosures. There is risk that subjective disclosures, at any given time, will be deemed erroneous and give rise to litigation over the error, especially if the entity's share value is affected by the disclosure. Finally, there will inevitably be litigation surrounding attorney-client privilege and attorney work-product protection.
- Competitive Disadvantage to the Disclosing Entity: Other companies, such as private companies that do not publish their financial statements and foreign companies not bound by FASB's rules and disclosure requirements, will be able to use the proposed required disclosures to their advantage by, for example, discrediting entities required to file the proposed disclosures when seeking business from common customers. Such disclosures would often be based on incomplete and/or unreliable information, especially early in litigation. Damage to the entity will be done regardless of whether or not the claims are ultimately deemed meritless.
- Inability to Audit to Professional Standards: The proposed required disclosures would not be susceptible to auditing that is consistent with professional standards since the quantitative and qualitative assessments required are mostly subjective given the unpredictability of unaccrued contingencies and the dynamic nature of litigation. By requiring information that is not capable of being properly audited, there is a strong risk that the credibility of the disclosures within the financial statements will be undermined; thus, providing little to no useful information to the financial statement users.

The Exposure Draft unfortunately does not wholly consider and properly balance the prejudicial impact of the required disclosures. We believe that financial statement users should be provided with the important facts underlying loss contingencies to make their own estimates. Such disclosures should however be limited to publicly available information or information that the reporting entity can make publicly available without creating additional risk or increasing existing risks. To avoid information overload and enable the financial statement user to focus on relevant information loss contingency disclosures should not be made for loss contingencies with insignificant probabilities of a loss.



Attached, please find responses to the questions as requested by the Board related to the Exposure Draft.

Sincerely,

A handwritten signature in black ink, appearing to read 'Ch. Huetten'. The signature is written in a cursive, flowing style.

Dr. Christoph Huetten  
Chief Accounting Officer  
SAP AG

A handwritten signature in black ink, appearing to read 'Bromley Jacobs'. The signature is written in a cursive, flowing style.

Bromley E. Jacobs  
Senior Manager of Accounting  
SAP America, Inc.

Attachment: Responses to questions as requested by the Board



## **Attachment: Responses to questions as requested by the Board**

*The Board requests that constituents provide comments on the following questions:*

*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?*

The proposed Statement would require companies to create costly and time-intensive new processes to assess unaccrued contingencies, including loss contingencies with very low probabilities of a loss that have so far not been subject to intensive internal analysis. The perceived benefits of the proposed disclosure requirements do not justify the additional cost and time that would be required to provide disclosures that would be unreliable due to the unpredictable nature of litigation and the difficulty in determining reliable estimates. Costs, and effort, could be reduced by limiting the proposed additional requirements to such information that is already publicly available and information that is not subjective in nature.

Further costs would result from the negative impact that such disclosures would have for the reporting entity:

- Three types of additional litigation could arise as a result of the proposed required disclosures and would create cost for the reporting entity: First, the requirement for entities to disclose unaccrued contingencies that are considered to be "near term" and of "serious impact", no matter what the likelihood of loss, indirectly encourages the filing of frivolous suits in an attempt to force entities to settle cases to avoid having to disclose that an extremely remote possibility exists of a "serious impact" loss. Second, litigation can arise from financial statement users who have based decisions on the subjective information contained within the disclosures. There is risk that subjective disclosures, at any given time, will be deemed erroneous and give rise to litigation over the error, especially if the entity's share value is affected by the disclosure. Finally, there will inevitably be litigation surrounding attorney-client privilege and attorney work-product protection.
- Competitive Disadvantage to the Disclosing Entity: Other companies, such as private companies that do not publish their financial statements and foreign companies not bound by FASB's rules and disclosure requirements, will be able to use the proposed required disclosures to their advantage by, for example, discrediting entities required to file the proposed disclosures when seeking business from common customers. Such disclosures would often be based on incomplete and/or unreliable information, especially early in litigation. Damage to the entity will be done regardless of whether or not the claims are ultimately deemed meritless.

*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?*

Not applicable (SAP is not party to a multiemployer plan)

*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?*

Entities should not be required to provide disclosures about loss contingencies, regardless of the likelihood of loss, even 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 entity's operations. This disclosure requirement would require an entity to analyze and disclose all potential



contingencies even if they have been deemed to be remote, provided they meet the terms of the "near term" and "serious impact" rules. This would be burdensome and in many cases result in the disclosure of items that could be dismissed in subsequent reporting periods. Furthermore, a determination of whether a loss contingency may meet the "serious impact" criterion may not be possible in a reasonable and reliable manner. Disclosure of such items may also affect the share value of the entity. We believe that the current rule, that no disclosure is required if the likelihood of loss is deemed to be remote, better serves the purpose of financial statements to present relevant and reliable information.

*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 believe that requiring disclosure of quantitative information about loss contingencies would result in improved reporting. In most cases, stated claims are stated by plaintiffs and are not subject to any meaningful review, nor do they have any real binding effect in litigation. Furthermore, initial claims stated by plaintiffs very often do not serve as a reasonable indicator for the final outcome of the litigation and therefore, only have very limited predictive value. A requirement to make an estimate of the maximum possible exposure would require entities to develop such estimates, even if during the normal course of litigation they would have no reason to assess the maximum exposure to loss to the degree required for public disclosures. To determine this maximum exposure, or range of exposure, in light of the unpredictable nature of litigation, and publicly stand behind these estimates would be burdensome and could put the entity at additional risk for collateral litigation. These estimates would most likely not be reliable, given the subjective factors used to determine their value and therefore, would not be useful to financial statement users.

*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 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. The entity's ability to determine an estimate that is reliable and will provide useful information would be extremely difficult, given the unpredictability of litigation cases, particularly at the onset of the case. Moreover, as the facts and circumstances around a loss contingency are constantly changing, an estimate may, only a short time after it has been made, not reflect the current status of the contingency.

*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?*

Current requirements of SFAS No. 5 provide adequate quantitative disclosures for accrued contingencies. Amounts accrued under this statement are deemed to be reasonably estimated and can be properly audited giving a greater reliability to the information presented. Additional quantitative and qualitative disclosures for unaccrued contingencies should include information which is already publicly available such as court filings.



*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?*

As stated previously (see response to questions #4a and #4b), it is unlikely that a reliable measure of the estimated maximum exposure could be determined that would be meaningful to users. This is particularly true given the unpredictability of litigation. Providing this information, which, in many cases, would not be reliable, would not serve to address the primary purpose of disclosure which is to provide financial statement users with reliable information by which they can assess the timing and amount of future cash flows.

*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 do not believe that entities should be required to disclosure of settlement offers made between counterparties in a dispute. Disclosure of such settlement would have a highly detrimental effect on on-going settlement negotiations with other parties and would interfere with future settlement negotiations. Entities currently in settlement negotiations with other parties would be indirectly providing information to these other parties that could be used against the entity in these negotiations. This same information could be used by other parties that have not yet entered settlement negotiations with the entity. Providing this type of information would be prejudicial and would create undue risk and financial exposure to the entity. Furthermore, we agree with the Board's view that settlement offers expire quickly and do often not reflect the status of negotiations only a short time later.

*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?*

The tabular reconciliation of recognized loss contingencies, provided on an aggregated basis, would not provide useful information about loss contingencies for assessing future cash flows and understanding changes in the amounts recognized in the financial statements. The tabular reconciliation will provide a historical view of recognized loss contingencies. It would be difficult to predict future cash flows from this information. The unpredictable nature of litigation cases can cause the amounts disclosed to vary greatly from one reporting period to another depending on where cases are in the litigation process. This will make extracting useful information from such a disclosure difficult, burdensome, and potentially confusing to the financial statement users.

*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?*

Exemptions should be included as part of any proposed changes to the current provisions stated within SFAS No. 5. However, providing the additional disclosures as required for unaccrued contingencies as set forth in the Exposure Draft would, in most cases, be prejudicial to the entity's position. As written, the proposed exemptions are vague and the requirement to disclose the nature of the exemption could, in and of itself, be prejudicial to the entity.

*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?*

While we believe that there should be prejudicial exemption, we also believe that the exemptions must be far broader than currently defined in the Exposure Draft. Exemptions will most likely be used far more frequently than currently thought by the Board as the nature of the qualitative disclosures, as currently proposed, will, in most cases, be prejudicial to the entity.

*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?*

As an opportunity for convergence and a means to provide more reliable and useful information to financial statement users, the Board should consider amending the proposed requirements of the Exposure Draft to bring SFAS No. 5 more in line with the current standards set forth in IAS 37. The current provisions of IAS 37 provide a more balanced approach to providing useful information to financial statement users while still allowing entities the ability to refrain from disclosing information that would be prejudicial to the entity and could potentially create undue financial risk to the entity's stakeholders.

IAS 37, while requiring additional disclosures for unaccrued contingencies as compared to the current provisions of SFAS No. 5, does not go so far as to require qualitative disclosures that could be prejudicial to the entity as is currently proposed in the Exposure Draft. Specifically, IAS 37 requires, for each class of contingent liability, a brief description of the nature of the contingent liability, and, where practicable, an estimate of its financial effect and an indication of the uncertainties relating to the amount and timing of any outflow. [IAS 37 para 86]. If information is not disclosed because it is not practicable to do so, the fact that the information was not disclosed is required to be stated. [IAS 37 para 91].

Under the proposed requirement of the Exposure Draft, entities would be required to provide qualitative disclosures that include, at a minimum, (a) a description of the contingency, including how it arose, its legal or contractual basis, its current status and the anticipated time of its resolution; (b) a description of the factors that are likely to affect the ultimate outcome of the contingency along with their potential effect on the outcome; (c) the entity's qualitative assessment of the most likely outcome of the contingency; and (d) significant assumptions made by the entity in estimating the quantitative disclosure and in assessing the most likely outcome. [Exposure Draft para 7a]. The proposed disclosure requirements outlined in (a) above are consistent with what is currently required under IAS 37. The proposed disclosure requirement outlined in (b), (c), and (d) will most likely be prejudicial in nature to the entity, particularly with respect to litigation cases. Although prejudicial exemptions, as stated in the Exposure Draft, are deemed to be rare, the exemption process, as proposed, is vague and too narrowly defined and will be used more frequently than is currently anticipated by the Board. The proposed exemptions do not give entities adequate latitude to be able to protect themselves from undue financial exposure and risk.

Although the exemptions under IAS 37 are expected to be "extremely rare", the standard does state that the exemption can be applied in any instance where the information that is to be disclosed would be prejudicial to the entity. Further, the standard requires instead that disclosure is made of the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed. [IAS 37 para 92].

In addition, IAS 37 does not require entities to disclose potential loss contingencies that have been deemed remote regardless of the potential timing and financial impact of the contingency. [IAS 37 para 86]. This is in direct contrast to the proposed requirement, under the Exposure Draft, for entities to disclose unaccrued contingencies that are considered to be "near term" and of "serious impact", no matter what the likelihood of loss. As stated previously, this proposed requirement of the Exposure Draft could lead to undue risks to the entity and its stakeholders.



*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, in part, with the description of prejudicial information as information whose "disclosure . . . could affect, to the entity's detriment, the outcome of the contingency itself". We believe that the description should be broadened to include ancillary prejudices such as the competitive disadvantage that could be realized by the entity when other parties use the entity's disclosures to gain an advantage over the entity when competing for business from common customers. Certain disclosures could be used by other parties even though the information in the disclosures is often based on unreliable information, especially early in litigation, regardless of whether or not the claims are ultimately deemed meritless.

*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 do not believe it is operational for entities to disclose all of the proposed requirements for interim and annual reporting periods. The disclosure requirement, as currently proposed in the Exposure Draft, would require processes that are far too time-intensive to report all requirements on an interim basis. Any required disclosures should be made for the annual reporting periods. While we do not believe that a tabular reconciliation should be included in the disclosures, if tabular reconciliations were to be required, they should only be done for annual reporting periods given the time-intensive processes that would be required to prepare such disclosures.

*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?*

SAP believes that the inclusion, in the disclosures, of information that is already publicly available would provide useful information to the financial statement users while not being prejudicial nor creating undue risk to the entity. Otherwise, SFAS No. 5, in its current form, requires sufficient information in its required disclosures for financial statement users to make informed decisions while still maintaining a balance between providing useful disclosures and retaining the sanctity of attorney-client privilege and attorney work-paper protection.

*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?*

As stated previously, SAP does not support the proposed changes as stated in the Exposure Draft in its current form. As the Board will need to analyze the comment letters, conduct roundtable discussion, and potentially reevaluate the provisions contained within the Exposure Draft, we do not envision this to be resolved in adequate time to be implemented for 2008. Should the Exposure Draft be adopted in its current form, entities will have insufficient time to properly put in place the time-intensive procedures that would be required to prepare the new disclosures. Moreover, entities that are subject to section 404 of the Sarbanes-Oxley Act would additionally need time to implement and document internal controls around the new disclosure processes. We therefore believe that the earliest possible effective date for implementation of any changes to the current provisions of SFAS No. 5 would not be prior to the end of 2009.