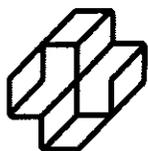




LETTER OF COMMENT NO. 63



hfma

healthcare financial management association

August 7, 2008

Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
Norwalk, Connecticut 06856-5116

File Reference No. 1600-100

Dear FASB Technical Director:

The Healthcare Financial Management Association's (HFMA's) Principles and Practices (P&P) Board appreciates this opportunity to comment on the Financial Accounting Standards Board's (FASB's) exposure draft of the proposed amendment to Statement of Financial Accounting Standards (FAS) No. 5, *Accounting for Contingencies* and FAS 141(r), *Business Combinations*, which would require expanded disclosures for certain loss contingencies.

HFMA is a professional organization of more than 35,000 individuals involved in various aspects of healthcare financial management. In 1975, HFMA founded the P&P Board, a special group of experts to serve as the primary advisory group in the areas of accounting principles and financial reporting practices to meet the unique characteristics of health service organizations.

In the exposure draft, the FASB sought comments on all matters in the proposed Statement, including a number of specific issues that need to be considered in the FASB's deliberations on the accounting and reporting for certain loss contingencies by amending FAS 5 and FAS 141(r). Our comments herein will center on these issues, and also will reflect the P&P Board's longstanding efforts to balance two important goals:

1. Financial reporting should improve the level of understanding between those who provide financial information and those who seek and use this information, and
2. Reporting requirements should be feasible in the context of the unique characteristics of the healthcare field.

### General comments

The P&P Board agrees with the FASB that generally, the proposed amendment to FAS 5 and FAS 141(r) has the potential to improve the overall quality of disclosures by providing more useful and timely information with respect to loss contingencies.

However, we have concerns that there is a danger of information being too speculative with respect to disclosure for certain classifications of loss contingencies. We also believe the speculative nature of certain information would obscure rather than illuminate an entity's obligations, and in some cases, the required disclosure will bring financial harm to entities.

Within the healthcare industry, there is a unique activity of self-insurance for malpractice claims. At any point in time, a healthcare provider may have a portfolio of asserted and unasserted claims. Typically, healthcare providers estimate losses from asserted and unasserted claims based on the best estimates of the ultimate costs of claims and relationship of past reported incidents to eventual claims for the entity and/or industry, with assistance from actuaries. The unique characteristics of these claims suggest that they should be excluded from the proposed amendment to FAS 5 and FAS 141(r) in a similar manner as FAS 60, *Accounting and Reporting by Insurance Enterprises*. Accounting guidance regarding these unique malpractice claims against healthcare providers is provided through the *AICPA Audit and Accounting Guide for Health Care Organizations [AAG-HCO]*. The P&P Board recommends that with respect to these industry-specific transactions, the AAG-HCO continue to provide guidance and that these claims be excluded from the scope of the proposed changes.

Below are the P&P Board's responses to the FASB's specific 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 P&P Board believes that disclosure in aggregate of amounts in the tabular reconciliation of recognized loss contingencies provides additional information which is helpful to a reader of financial statements. However, the additional detailed disclosure of

File 1600-100, proposed amendment to FAS 5, *Accounting for Contingencies* and FAS 141(r),  
*Business Combinations*  
August 7, 2008

amounts of claims and maximum potential payments is problematic, as further addressed in the Q&A below.

The proposed disclosure would entail additional work on the part of management in compiling information, and also additional cost of auditors and outside law firms, and as further addressed in the Q&A below, would not yield better information for users of 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?**

Disclosure of obligations that may result from withdrawal from a multiemployer plan should only be required if it is the entity's intent to actually withdraw from such a plan. Disclosures of the consequences of activities that are not being contemplated are a distraction to the user of financial statements. Such quantification may also require additional actuarial fees.

The P&P Board suggests that this issue be addressed along with disclosure requirements for pension plans, so that it is addressed in the appropriate context.

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?**

The P&P Board supports the concept of disclosure, however in many instances this will be prejudicial as further discussed below in the Q&A; therefore, the P&P Board does not support this proposed requirement.

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?**

While the P&P Board appreciates the need for more quantitative information with respect to loss contingencies, it is important that such disclosures contribute to a meaningful representation of the entity's exposure, and the proposed amendment does not accomplish this.

In many cases, as acknowledged by the FASB, claims are made for very high amounts as a negotiating strategy, and are not indicative of any real exposure to the entity. Indeed, claims are rarely settled for the initial claim amount. Further, particularly when claims are aggregated, such as in the case of a portfolio of self-insured malpractice claims, the aggregation of maximum exposure for each claim yields a total that vastly distorts the picture of what could ever occur (i.e., the probability is beyond remote).

A distinction should also be made with respect to governmental challenges, such as claims made by the Department of Justice or Office of the Inspector General against healthcare providers. As healthcare providers are subject to voluminous and complex laws and regulations of federal, state, and local governments, an entity can be subjected to future government review and regulatory actions unknown or unasserted. Government inquiries and investigations often begin with information requests, which do not provide a basis for which an entity can truly estimate the exposure of claims. The aggregation of maximum exposure to such claims would also yield a total that does not reflect what could ever occur.

Disclosure of management's estimate of maximum exposure has similar inherent limitations. Such disclosure could cause the reader of financial statements unnecessary alarm and does not provide any value-added indication to the reality of what outcome would typically occur. Alternatively, readers may learn that such disclosures are meaningless and should be ignored.

The most serious concern with such disclosure, however, is the possibility of unwarranted damage to the entity. Disclosure of maximum amounts would encourage plaintiffs to hold out for more than the claim might reasonably be worth, and have the unintended consequence of discouraging early settlements. In addition, disclosure of maximum amounts will serve to encourage additional claims against an entity (it indeed may spawn a whole industry of consultants who read financial statements to recruit clients, or encourage a multitude of false claims against entities with the intent to simply damage them as a result of the required disclosure) and will hamper the entity's ability to resolve issues at lower amounts. Past experience shows that settlements have rarely been made for the initial claim amount. The current proposal does not offer sufficient protection against such unjustified lawsuits.

- 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?**

Based on the reasons presented in our response to question 4a, we do not believe required disclosure of a possible range of loss is appropriate.

- 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?**

As a compromise between the needs of the user and the interests of the disclosing entity, the P&P Board suggests adding the tabular reconciliation of recognized loss contingencies in aggregate, but not changing the existing disclosure requirements.

- 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?**

Such estimates are often not meaningful to users as they paint a worst case, can cause unnecessary alarm, and are prejudicial.

File 1600-100, proposed amendment to FAS 5, *Accounting for Contingencies* and FAS 141(r),  
*Business Combinations*  
August 7, 2008

- 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?**

The P&P Board agrees with the FASB that settlement offers should not be disclosed, because amounts are often a poor and misleading indicator of exposure and are often simply offered as a negotiating tool with no real expectation of acceptance by the other party.

- 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?**

Yes, the tabular reconciliation will promote transparency by allowing users to understand activity in an entity's financial statements. The P&P Board is concerned, however, that this may result in financial statements with excessive amounts of roll-forward documentation. We recommend, again, that the scope be limited to material items.

- 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?**

The P&P Board strongly agrees that the exemption should be provided and the exemption should be extended further so that an entity need not disclose the amount of the claim or management's estimate of the maximum exposure. It would be unfortunate to have disclosure rules that caused financial harm to entities.

- 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?**

The first step (aggregation at a higher level) as outlined is acceptable. The second step does not go far enough. An entity should be exempted from disclosing the amount of claims or assessments in circumstances where it is prejudicial.

- 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?**

Because of the volume and diversity of lawsuits against healthcare providers in the United States, the P&P Board agrees with the FASB that under the proposed Statement, the IAS 37 requirement that these exemptions are *extremely rare* is inappropriate. The current proposal is an improvement, but also is inappropriate, in that the P&P Board believes that the prejudicial exemption will need to be invoked frequently.

- 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?**

The description is adequate; however, we believe that disclosure is prejudicial in most instances, and therefore use of the exemption will be the rule, not the exception.

- 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?**

If the proposed amendment to FAS 5 and FAS 141(r) is required, it is reasonable that the disclosure of required information be made for annual reporting periods, but should not be required on an interim basis.

- 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?**

File 1600-100, proposed amendment to FAS 5, *Accounting for Contingencies* and FAS 141(r), *Business Combinations*  
August 7, 2008

The proposal could be strengthened by addressing how it pertains to tax issues and asset retirement obligations. Also, the P&P Board suggests that disclosure associated with self-insured malpractice programs, which are unique to the healthcare industry and which are different from other contingent liabilities in that they are often numerous and are typically estimated actuarially, be subject to the requirements outlined in the *AICPA Audit and Accounting Guide for Health Care Organizations* or FAS 60, instead of the proposal here.

**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?**

There would be a burden on entities to implement the proposed amendment to FAS 5 and FAS 141(r) as of the effective date noted. In addition to the concerns raised in the body of this comment letter, concerns with respect to the implementation of the proposed amendment include:

- Significant process changes required to establish and agree on the appropriate level of work to be performed by auditors and attorneys (who both must issue opinions in conjunction with the issuance of audited financial statements)
- Costs that will be incurred by the entity to establish systems to collect the required information.
- Significant process challenges and costs required to determine what corroborative evidence entities could provide to auditors to support the internal controls over financial reporting for these disclosure requirements, as well as validity of possible estimates made by management.

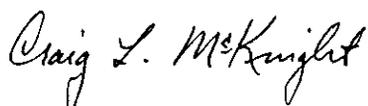
HFMA

Page 9

File 1600-100, proposed amendment to FAS 5, *Accounting for Contingencies* and FAS 141(r),  
*Business Combinations*  
August 7, 2008

Thank you for the opportunity to comment. We are always ready to provide additional comments, or meet with you to discuss this matter further. If we can provide additional material or perspective on this issue, please contact Richard Gundling, Vice President of HFMA's Washington, DC office at (202) 296-2920.

Sincerely,



Craig L. McKnight, CPA  
P&P Board Chair

#### **About HFMA**

HFMA is the nation's leading membership organization for more than 35,000 healthcare financial management professionals. Our members are widely diverse, employed by a variety of healthcare providers, accounting and consulting firms, and insurance companies. Members' positions range from chief executive officer and chief financial officer to patient accounts manager and accountant.

HFMA is a nonpartisan professional practice organization. As part of its education, information, and professional development services, HFMA develops and promotes ethical, high-quality healthcare finance practices. HFMA works with a broad cross-section of stakeholders to improve health care by identifying and bridging gaps in knowledge, best practices, and standards.

#### **About HFMA's Principles & Practices Board**

HFMA established the Principles and Practices Board in 1975 to reevaluate, clarify, and establish accounting principles and financial reporting practices to meet the unique characteristics of health service organizations.

The P&P Board consists of twelve members who have demonstrated technical competence in the industry and possess outstanding personal and professional qualities. At least six members must be employees of provider organizations; six or fewer members must work in organizations that serve the industry.