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LETTER OF COMMENT NO. 3

committee on corporate reporting

April 17, 2008

Mr. Robert H. Herz  
Chairman  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

**Re: Disclosures about Loss Contingencies-Potential Amendment of FAS 5**

Dear Mr. Herz:

The Committee on Corporate Reporting ("CCR") of Financial Executives International ("FEI") wishes to share its views on one particular matter concerning the Financial Accounting Standards Board's ("FASB" or "Board") reconsideration of FASB Statement No. 5 – Accounting for Contingencies ("FAS 5"). Specifically CCR is concerned with the implications this project will have on the accounting and disclosures of loss contingencies related to litigation; particularly the prejudicial impacts these changes will have on ongoing or threatened litigation.

FEI is a leading international organization of senior financial executives. CCR is a technical committee of FEI, which reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. This document represents the views of CCR and not necessarily the views of FEI or its members individually.

FAS 5 has been in existence for over 30 years and represents an excellent example of a principles-based standard. CCR has been carefully following the Board's re-deliberations of FAS 5. We note the Board's views that changing business, legal and regulatory conditions and evolving investor needs and concerns, now warrant a re-consideration of the recognition, measurement and disclosure requirements of FAS 5. At this time we are not suggesting that the other contingencies in the scope of FAS 5 should not be vetted and we are not taking any position with respect thereto; quite the contrary we believe this is an appropriate project for the Board.

However, CCR is very concerned about any changes to FAS 5's guidance with respect to loss contingencies related to litigation. CCR acknowledges the Board has stated that it does not, per se, intend that any revision of FAS 5 will require disclosures that are prejudicial to the interests of the financial statement preparer. However, we believe that any incremental disclosures, other than a description of the legal action, could potentially be useful to a plaintiff. Further we believe if the expectation of any revision to FAS 5 is for more disclosure that it will be difficult for a financial statement preparer to avoid making disclosures that would, or could, be prejudicial. Accordingly, we strongly recommend litigation be removed from the scope of the project and the current requirements of FAS 5 remain in effect. Our reasons are set forth below.

### **Litigation is different from other contingencies:**

We believe loss contingencies related to litigation are very different from all other contingencies within the scope of FAS 5. The other in-scope contingencies tend to be much more operational in nature, lend themselves more readily to reasonable estimation, are frequently more predictable as to timing and cash flows and in general are more of an ordinary course of business item. Litigation on the other hand is anything but operational and ordinary course of business. It is an *adversarial situation and subject to a set of legal and judicial processes* with the objective being the extraction of funds and other forms of compensation for the plaintiff's benefit. The end result of litigation is frequently very difficult to predict. For example, predicting the outcome of intellectual property litigation has proven to be very problematic particularly in markets that do not yet have meaningful judicial or administrative precedents upon which a company and its counsel can predict with reasonable accuracy a specific result. Additionally litigation is often brought for other reasons such as for publicity, negotiating leverage on another matter, political and social agendas, etc. Due to the nature of litigation and the attendant legal processes, whether a company has a measurable liability is inherently uncertain; the degree of such uncertainty being much higher versus the other in-scope FAS 5 contingencies. Therefore a litigation contingency is exceptionally different from any other type of contingency; so much so we believe as to readily justify different accounting and disclosure requirements.

### **Changes to FAS 5 will be harmful to investors:**

CCR has consistently supported the Board's objective of continuous improvements to financial accounting and reporting for the benefit of financial statement users. We strongly believe the direction this project is trending will, however, be detrimental to those needs in several respects:

- We believe the FASB is, in effect, asking the wrong question of financial statement users. We expect users would affirmatively respond if the question is "Do you want more information about litigation?" However if the question posed was "Do you want more information about litigation if providing this information aided the plaintiffs and could conceivably cost the Company, and shareholders such as yourself, a lot of money?" We submit the answer to this question is much less clear and will frequently be "no."
- Litigation is inherently unpredictable; the path towards resolution is long and winding with frequent changes in direction. Major litigation is dynamic and transitory; it has numerous ups and downs and management's assessment will frequently change as new information or legal theories emerge, settlement and trial strategy evolve, venues change, judges are assigned, rulings are issued, etc. Accordingly, assessments of potential litigation outcomes are highly subjective and difficult to provide with any degree of precision. Further, there are situations where for short windows of time it may be tactically advantageous to settle a claim but not so advantageous later. Our concern is that to more fully disclose (versus current practice) and assess four times per year, the status of open litigation mostly provides information useful only to a company's legal adversaries. It is difficult to envision how this information would be useful to a typical investor especially when disclosed without the fuller context that a plaintiff would have.
- Building on the above point, we believe expanded litigation disclosures will frequently lead to investor confusion and poor investor decision making. This is because accurate disclosures are often very technical and best understood by those closest to the situation or by trained attorneys. For example, a company's strategy may contemplate losing at a district court level because it is a necessary procedural step in order to get to an appeals court level where a successful outcome is expected. Likewise litigation strategy may lead a company to take, or not take, certain actions in order to preserve rights for appeal. We could enumerate many additional examples however our point is that expanded disclosures will be difficult to understand without context and inside knowledge. What

may seem to an outside party to be a good, or bad, development may be little more than a routine step in the process. Further to disclose that a company expects to lose in a lower court but will win on appeal is not likely to have a salutary effect on the judges involved. As a consequence investor decisions might be based on an incomplete understanding of the situation – the exact issue the expanded disclosures are intended to rectify.

In addition, we note that on December 4, 2007 you received a letter from the chief litigators from a number of major U.S. corporations. We concur with the concerns they raised. They raised numerous valid points which are fully consistent with the issues and concerns we have discussed herein.

**Expanded disclosure conflicts with management’s fiduciary responsibilities:**

It is the responsibility of the management of every company to do everything that is commercially reasonable to protect the company’s assets for the benefit of its shareholders and other investors. One of the ways management carries out this responsibility is by keeping confidential information that could be useful to an adversary. Well managed companies have extensive internal policies which strictly control the dissemination of information which is harmful to the company’s interests. The Board’s project to expand loss contingency disclosures is diametrically opposed to these fiduciary requirements. Management always has the option to make voluntary disclosures regarding the status of litigation but should not be compelled to do so beyond the current requirements of FAS 5 and the related practices that have developed over the years. CCR believes that by requiring expanded disclosures which management would frequently view as ill advised, the Board has inadvertently inserted itself into the management process. We do not believe this is what the Board intended but it will be an unintended consequence of this project’s direction.

**Impact on Attorney-Client and Auditor-Client Communications:**

We believe a likely, and unfortunate, outcome of expanded disclosure requirements will be a retardation of attorney-client and auditor-client communications. In the FASB’s ideal scenario earlier and more expansive disclosures about the status of litigation will become “the norm”. Attorneys, with their responsibility to protect their clients’ interests, will need to be cognizant of management’s new disclosure obligations. We can easily envision scenarios where a company’s litigation counsel becomes more circumspect about the advice and legal analysis they provide to their clients because they will be concerned about the possible need to disclose such. We acknowledge the Board does not seek to prejudice a company’s interests as a result of new disclosures and we appreciate that disclosures may be accumulated at a higher level than an individual case. That said, the mere internal gathering of the lower level information necessary for the aggregation may very well be discoverable in due course. Further, both management and litigation counsel will need to be cognizant of management’s responsibilities to comply with, and the auditor’s responsibilities to enforce FASB pronouncements even if the client would otherwise prefer to avoid these disclosures. It is obvious to us that one way to avoid putting the auditors in this spot is to be more deliberative about the information that is shared with them. We strongly believe neither of the above reductions of information flow is desirable however we believe this is what will frequently result.

**Goal Congruence with the Progress Report of the Advisory Committee on Improvements to Financial Reporting (CIFR):**

As you are aware, the initial report of the CIFR committee contained many recommendations with respect to the standards setting process. Among the proposals was the call for expanded pre-issuance field tests by the Board and staff. We believe the FAS 5 reconsideration project as it relates to litigation is an excellent project to apply this CIFR recommendation. We strongly encourage the field testing be conducted before the Exposure Draft is released. Further, as part

of the field test we strongly encourage the Board to include the American Bar Association, or appropriate committee thereof, as part of this process.

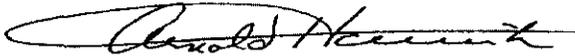
### Summary

CCR is extremely concerned about the guidance we expect the Board will recommend. We believe FAS 5 as it relates to litigation contingencies has worked reasonably well over the past three plus decades and remains an excellent example of principles based accounting. Its requirements and limitations are well understood by all relevant parties and working protocols have emerged over the years. We acknowledge that situations have occurred when companies recognized litigation losses and a review of prior disclosures may not have provided sufficient warning of impending losses. However we suspect that if these situations are analyzed that many of the losses were also unforeseen by management and that the loss occurred due to the difficulty of assessing litigation outcomes process rather than a conscious decision not to provide disclosures. It should be noted however, that there is nothing that prohibits management from making today what might be considered voluntary disclosures on litigation if they consider it appropriate and in the shareholders best interests to do so. We strongly recommend to the Board that there be no changes to the current requirements of FAS 5 as it relates to litigation.

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We appreciate the Board's consideration of these matters and welcome the opportunity to discuss any and all related matters. We will more fully respond to the Exposure Draft when it is published and we expect to have additional comments at that time. We understand the Board is considering having some roundtable meetings to more fully vet the concerns of the preparer community. We strongly endorse such a step and we would be pleased to participate in any such meetings.

Sincerely,



Arnold C. Hanish  
Chairman, Committee on Corporate Reporting  
Financial Executives International