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August 8, 2008



LETTER OF COMMENT NO. 217

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

**Re: File Reference No. 1600-100 – Proposed Statement of Financial Accounting Standards, Disclosure of Certain Loss Contingencies, An Amendment of FASB Statements No. 5 and 141(R)**

Dear Mr. Golden:

We appreciate the opportunity to comment on the proposed Statement of Financial Accounting Standards on “Disclosure of Certain Loss Contingencies, an amendment of FASB Statements No. 5 and 141(R)” (Exposure Draft). Our comments on the Exposure Draft address audit issues related to the proposed disclosure requirements, the need for the FASB to address other issues related to the accounting for contingencies, other matters related to the proposed disclosure requirements, the importance of the planned field tests, and the proposed effective date.

If the Exposure Draft is finalized in its present form, preparers of financial statements would need to develop additional information about contingencies to comply with the proposed disclosure requirements. Disclosure of such information was not contemplated when the current standards and interpretations followed by auditors to obtain audit evidence about certain contingencies, and the related “Statement of Policy Regarding Lawyers’ Responses to Auditors’ Requests for Information” of the American Bar Association (ABA Treaty), were developed. We believe that the respective auditing standard setters (PCAOB and AICPA Auditing Standards Board) must reconsider existing auditing literature, and collaborate with the ABA on necessary revisions to the ABA Treaty, in light of the proposed disclosure requirements before the FASB finalizes any revisions to the disclosure requirements of Statement 5.

Further, we believe that, prior to amending the required disclosures under Statement 5, the FASB should first address the inconsistencies in accounting for contingencies under Statement 5 and Statement 141(R). The Board’s conclusions regarding loss contingency recognition and measurement matters could impact related decisions regarding amendments to the disclosure requirements of Statement 5.



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Should the Board continue to pursue this amendment to Statement 5, we believe that preparer and user field testing of the provisions of the Exposure Draft would assist in identifying those disclosures that are particularly relevant to users and obtaining a better understanding of the specific issues that preparers will encounter in developing the necessary information to meet the proposed disclosure requirements. Information obtained through the field tests may enable the Board to develop less prescriptive requirements that would improve disclosures about loss contingencies as compared to existing disclosures made pursuant to the current requirements of Statement 5. In addition, auditors, the auditing standard setters, and representatives of the ABA should participate in the field testing to address the auditability of the proposed disclosures and the quality of corroborating audit evidence obtained by auditors from their clients' lawyers. Extensive field testing also will provide a basis for the Board to refine its initial cost/benefit analysis in the Exposure Draft. As described in paragraph A37 of the Exposure Draft, the Board concluded that the benefits of the proposed disclosures outweigh the costs. However, paragraph A36 notes the Board plans to conduct field testing to better assess the relative costs and benefits. We do not believe the Board can support its assertion in paragraph A37 without the extensive field testing we recommend in this letter.

Prior to issuing a final Statement, we believe that 1) the PCAOB, the AICPA, and the ABA must revisit the ABA Treaty, 2) the FASB should address the inconsistencies in accounting for contingencies under Statement 5 and Statement 141(R), and 3) the FASB should complete field testing of the proposed disclosures with preparers, users, lawyers, and auditors and analyze the information obtained from the field tests. Given the time required to address those matters, we believe that the proposed effective date in the Exposure Draft for annual financial statements issued for fiscal years ending after December 15, 2008 is not feasible.

### **Audit Issues**

The Exposure Draft proposes that companies be required to disclose certain quantitative and qualitative information relating to material loss contingencies that are considered more than remote (subject to certain specific exceptions that would require specific disclosures even if the contingency was remote). The proposed disclosures include, but are not limited to: (a) "[t]he amount of the claim or assessment against the entity" or, if such is unavailable, "the entity's best estimate of the maximum exposure to loss;" (b) "a description of the contingency, including how it arose, its legal or contractual basis, its current status, and the anticipated timing of its resolution;" (c) "a description of the factors that are likely to affect the ultimate outcome of the contingency along with their potential effect on the outcome;" (d) "the entity's qualitative assessment of the most likely outcome of the contingency;" and (e) "the significant assumptions



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made by the entity in estimating the amounts disclosed... and in assessing the most likely outcome.”

With regard to litigation, claims and assessments, PCAOB and AICPA auditing standards indicate that auditors should obtain audit evidence relevant to (AU 337.04):

- (a) [t]he existence of a condition, situation, or set of circumstances indicating an uncertainty as to the possible loss to an entity arising from litigation, claims, and assessments; (b) [t]he period in which the underlying cause for legal action occurred; (c) [t]he degree of probability of an unfavorable outcome; and (d) [t]he amount or range of potential loss.

Accordingly, existing auditing literature does not specifically address matters associated with the entity’s best estimate of the maximum exposure to loss, 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 the significant assumptions made by the entity in estimating the amounts disclosed and in assessing the most likely outcome.

Further, PCAOB and AICPA auditing standards provide that, “[a] letter of audit inquiry to the client’s lawyer is the auditor’s primary means of obtaining corroboration of the information furnished by management . . .” (AU 337.08). However, the ABA Treaty does not compel a lawyer to provide information relative to certain disclosures proposed in the Exposure Draft. Accordingly, absent substantive amendment to the ABA Treaty, lawyers likely will not provide the information necessary for an auditor to corroborate management’s representations supporting such disclosures. In addition, AU 337, paragraph 13, states that, “[a] lawyer’s refusal to furnish the information requested in an inquiry letter... would be a limitation on the scope of the audit sufficient to preclude an unqualified opinion”.

In addition, the ABA Treaty does not recognize the Board’s more-likely-than-not threshold for recognition of certain loss contingencies in business combinations and the related fair value measurement approach for recognized contingencies in Statement 141 (R). Rather, the ABA Treaty references outcome probabilities in the context of “remote” and “probable”. Accordingly, financial statement preparers will be required to determine, and auditors will be required to assess, the propriety of accounting and disclosure matters associated with loss contingencies by reference to a benchmark that is different from the one lawyers use when responding to auditor inquiries on the same subject.

We understand that the PCAOB is evaluating whether further standard-setting or some other form of guidance is necessary on the subject of auditing loss contingencies. We believe that the



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PCAOB and AICPA must reconsider the relevant existing auditing literature and collaborate with the ABA on necessary revisions to the ABA Treaty to address the new requirements of Statement 141(R) and any potential changes to disclosure requirements in Statement 5. The FASB, the auditing profession, the legal profession, and the preparer community should actively participate in that initiative. We believe that amendments to existing auditing literature and the ABA Treaty must be addressed before the FASB finalizes revisions to the disclosure requirements of Statement 5.

### **Inconsistencies between Statement 5 and Statement 141(R)**

The FASB announced that on June 11, 2008, the second phase of its project on accounting for contingencies, which was to address recognition and measurement of contingencies, “was removed from the Board’s agenda because the Board plans to consider at a future date whether to address that accounting in a joint project with the IASB.” (From the Accounting for Contingencies project update on the FASB’s website.) We do not agree with that decision.

As described in the Basis for Conclusions in Statement 141(R), the FASB’s conclusions on accounting for contingencies in business combinations and the subsequent measurement of those assumed contingencies represented a practical alternative that would not prejudice the outcome of its deliberations on its project to reconsider Statement 5. We understand that the Board needed to address accounting for contingencies acquired in business combinations in the development of Statement 141(R). However, the Board acknowledged in the Basis for Conclusions in Statement 141(R) that “different measurement of similar assets and liabilities would make financial reports more difficult to understand.” We agree with that concern and believe that the inconsistencies in the recognition and measurement of assets and liabilities arising from contingencies acquired or assumed in a business combination as compared to the accounting for such assets and liabilities that arise outside of a business combination need to be addressed in a timely manner to reduce the length of time those inconsistencies will exist as companies begin to apply Statement 141(R) in 2009. We believe the need to address and resolve those inconsistencies is greater than the need to reconsider the disclosure requirements of Statement 5. Accordingly, we believe that the Chairman should put the recognition and measurement of contingencies project back on the Board’s agenda and consider seeking to make it a joint project with the IASB.

In addition to the need to address the inconsistencies in accounting for contingencies under Statement 5 and Statement 141(R), we believe that the recognition and measurement phase of the project to reconsider Statement 5 should be addressed before making changes to the disclosures about contingencies because the conclusions about disclosures may differ depending on the outcome of the recognition and measurement issues. For example, if the Board ultimately concludes that contingencies should be measured at fair value each reporting period, the Board’s



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decisions about appropriate disclosures under that recognition and measurement approach may differ significantly from what the Board has proposed in the Exposure Draft.

### **Proposed Disclosure Requirements**

We recognize that enhanced disclosures about contingencies may be useful to users of financial statements. However, in addition to our concerns set forth above, we question the basis for certain provisions of the proposal and we believe that it would be possible to enhance disclosures about loss contingencies with less prescriptive disclosure requirements. The field test process, including obtaining additional input from users on their specific needs, could provide additional information that would enable the Board to enhance the disclosures for users while at the same time mitigating the concerns of preparers about the proposals in the Exposure Draft.

Paragraph A3(b) of the Exposure Draft indicates that constituents have expressed concerns that the at-least-reasonably-possible threshold for disclosing loss contingencies has not resulted in disclosures about the full population of loss contingencies that would be of interest to users of the financial statements. In paragraph A12, the Board discusses how it believes it would expand the population of loss contingencies that would be disclosed by requiring disclosures about contingencies unless the likelihood of loss is remote, except for loss contingencies that may have a severe impact in the near term. Because Statement 5 defines “reasonably possible” as being “more than remote but less than likely”, we question whether changing the disclosure threshold from “at least a reasonable possibility” to more than “remote” will impact significantly the population of items that would be disclosed or accomplish the Board’s objective. In addition, if the Board changes the description of the disclosure threshold for loss contingencies, we suggest that the Board describe the threshold in the same manner for other contingencies described in other accounting literature, such as AICPA Statement of Position 94-5, *Disclosure of Certain Matters in the Financial Statements of Insurance Enterprises*, AICPA Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, and AICPA Statement of Position 96-1, *Environmental Remediation Liabilities*. Using different descriptions for the disclosure threshold for different contingencies makes the accounting standards unnecessarily complex.

Although we agree that disclosures about loss contingencies that could have severe impact in the near term would be appropriate even when the likelihood of occurrence may be remote, we do not believe it is necessary to include the same level of disclosures about those loss contingencies as other contingencies that have a higher likelihood of resulting in a loss to the entity. A general description of the nature of the exposure, with less extensive detailed quantitative and qualitative information, may be sufficient for those loss contingencies that are determined to be remote but may have a severe impact in the near term.



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A tabular reconciliation is required for both annual and interim periods. We note that the Board did not require presentation of the tabular reconciliation of tax uncertainties in interim periods in FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes." Such inconsistencies make accounting standards unnecessarily complex. We believe the interim period disclosures about contingencies as required by Regulation S-X are sufficient and therefore a tabular reconciliation for interim periods is not necessary.

Paragraph 10 of the Exposure Draft would require disclosures about liabilities that may have been incurred after the balance sheet date but before the financial statements are issued. We believe that paragraph 10 needs to be clarified to refer to loss contingencies where the underlying cause occurs after the balance sheet date rather than to any liability that is incurred after the balance sheet date. With respect to loss contingencies where the underlying cause occurs after the balance sheet date, the proposed provisions of paragraph 10 would require the same disclosures that would be required for loss contingencies where the underlying cause occurred prior to the balance sheet date. We question whether companies would be able to develop all of the information required for, and auditors would have the time necessary to audit, the disclosures related to contingencies whose underlying cause arise after the balance sheet date. The Board should consider whether less extensive disclosures of those subsequent events could accomplish the Board's objective. The Board's field tests may provide useful information about the ability to develop the necessary information for subsequent events.

In paragraph 11 of the Exposure Draft, the Board suggests that disclosure of information that would be required by the proposed provisions may be prejudicial to an entity's position in "rare" instances. During its field tests, the Board should consider whether its assumption that such instances would be "rare" is correct. In addition, if the Board concludes that certain disclosures would not be necessary in those "rare" instances, the Board should consider whether the minimum disclosure requirements for those instances would be sufficient for situations that may not qualify for the prejudicial information exemption.

We believe that the final Statement should include examples to illustrate the disclosures required by the final provisions of the Statement. We understand that disclosures about loss contingencies are dependent on the individual facts and circumstances and that the Board could not provide numerous extensive examples that would attempt to cover all situations. However, we believe that the Board could provide some basic illustrative disclosures, similar to the illustrative disclosures the Board provided in Interpretation 48 that would help convey the extent of information that the Board would expect entities to disclose to meet the requirements. We also do not agree with the Board's amendments that would delete the illustrations from SOP 96-1. Instead, we believe those illustrations should be updated to illustrate any new disclosure requirements.



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### **Field Testing**

We support the Board's efforts to perform field testing of the provisions of the Exposure Draft. Field testing with preparers and their legal advisers should provide the Board with a better understanding of the specific issues that preparers will encounter in developing the necessary information to meet the disclosure requirements and the concerns preparers may have about disclosing that information. This field testing also will provide the Board with insight as to the costs preparers may incur to develop and provide the required disclosures. These costs should be evaluated against the perceived benefits derived from the incremental disclosures. Due to the audit issues noted above, we believe that auditors and the auditing standard setters should participate in the field test process.

In addition to field tests with preparers and their legal advisers, we believe that the Board should field test the proposed disclosures with users of financial statements. Field testing the proposed disclosures with users of financial statements could assist the Board in obtaining a better understanding of the specific enhancements to Statement 5 that users believe are needed. Understanding the needs of users and the value they assign to the incremental disclosures will assist in determining if the benefits of the incremental disclosures outweigh the costs and concerns identified by preparers and their legal advisers.

Field testing also should assist the Board in developing illustrative disclosures that could be included in the final Statement.

### **Effective Date**

The proposed effective date for fiscal years ending after December 15, 2008 is unrealistic. As discussed above, we believe it would be more appropriate for the Board to delay any changes in the existing disclosure requirements in Statement 5 until the Board has addressed the inconsistencies in accounting for contingencies between Statement 5 and Statement 141(R). However, even if the Board proceeds with the changes in the disclosure requirements before addressing the recognition and measurement issues, audit issues must be addressed by the auditing standard-setting bodies and the ABA, field tests will need to be completed, and the Board will need to consider the extensive concerns expressed by preparers and the results of the field tests before the Statement can be finalized. Completing those steps and finalizing a standard that could be implemented for the year-end 2008 financial statements is not feasible.

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If you have any questions about our comments or wish to discuss any of the matters addressed in our comments, please contact Mark Bielstein at (212)-909-5419.

Sincerely,

**KPMG LLP**

cc: Conrad Hewitt – Securities and Exchange Commission  
John W. White – Securities and Exchange Commission  
Mark W. Olson – Public Company Accounting Oversight Board  
Thomas Ray – Public Company Accounting Oversight Board