

McGladrey & Pullen
Certified Public Accountants



LETTER OF COMMENT NO. 199

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August 11, 2008

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

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 are pleased to comment on the proposed Statement of Financial Accounting Standards, *Disclosure of Loss Contingencies, an amendment of FASB Statements No. 5 and 141(R)*.

While we support the Board's efforts to provide investors with improved disclosures related to loss contingencies, we don't believe the proposed Statement is practical, will be able to be implemented or will accomplish that objective. Our primary concerns related to the proposal are as follows:

- We believe that reporting entities are unlikely to have systems currently in place that would allow them to make the estimates required by the proposed disclosures. Partly because of that concern, we believe it will be difficult to determine values to include in many of the disclosures and therefore it is unlikely that amounts included in the disclosures would be reliable.
- From a legal perspective, we are concerned that a reporting entity may find itself in a situation in which disclosing information in the footnotes to the financial statements would hinder its ability to optimize its legal strategies. Furthermore, a reporting entity could be subject to additional litigation if the amounts disclosed are not reliable which, as stated above, we believe would be the case.
- We are concerned that the information required by the proposed Statement will be extremely difficult to audit and may, in some cases, be unauditably. Under the existing treaty between the American Institute of Certified Public Accountants (AICPA) and the American Bar Association (ABA), auditors do not receive the evidence that would be required to corroborate management's assertions. Accordingly, we do not believe that the proposed disclosures could be subject to audit without revisions to that treaty.

Even if our primary concerns were effectively resolved prior to issuance, we believe that the proposed effective date of the standard is not reasonable. We suggest that the effective date be deferred to give reporting entities the requisite time to develop systems to determine reliable information and to give the AICPA and ABA time to address any necessary revisions to their treaty.

Finally, we believe that our concerns about management's ability to make reliable estimates and auditor's ability to audit those estimates extends to the estimates required by paragraph 24b of FASB Statement 141(R). As a result, we recommend that the Board consider deferring the effective date of that paragraph of that Statement or, in the alternative, the effective date of the entire Statement.

The remainder of this letter contains our responses to the specific questions posed in the Exposure Draft.

- 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?**

We don't believe the benefits of the proposed disclosures will justify the incremental costs. As indicated in our summary comments, we believe those costs include:

- Potential limitation on a reporting entity's legal options
- Requiring entities to develop systems to generate the required information
- Potential additional legal exposure of reporting entity when estimates are not reliable
- Exposing auditors to audit risk if they are unable to obtain sufficient appropriate audit evidence
- Requiring a change to the treaty between the AICPA and the ABA

We are very concerned about the "cost" of potentially limiting a reporting entity's legal options and suggest the Board solicit additional input from affected parties (including the ABA) as to the comparison of potential costs to potential benefits.

- 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 obligation, which are currently subject to the provisions of Statement 5? Why or why not?**

We agree with the Board's decision to include these obligations within the scope of the proposed Statement.

- 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?**

We don't believe an entity should be required to provide disclosures about loss contingencies for which the loss is remote, even if the resolution is expected to occur within one year and the potential impact could be severe. We don't see the logic behind not disclosing information about a loss contingency for which the loss is considered remote for potentially many years, but then disclosing it as it comes nearer a resolution. Also, we don't foresee this required disclosure resulting in meaningful information; instead, we believe the disclosures will devolve into standardized, boilerplate-type disclosures.

- 4. Paragraph 10 of Statement 5 requires entities to "give an estimate of the possible loss range 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 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?**
- 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?**
- 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?**

We don't object to the requirement that entities disclose the amount of the claim or assessment. We believe, however, there are certain circumstances when disclosing a best estimate of the maximum possible exposure will not be useful information. We believe that a best estimate of the maximum possible exposure to loss should only be required to be disclosed if the amount can be reasonably estimated. We believe, however, that in many instances, a best estimate of the maximum possible exposure to loss will not be calculable on a reliable basis. In those instances, we believe that an entity should be allowed to disclose that a reliable estimate cannot be made.

We believe disclosure of the possible loss or range of loss should be optional, rather than required, as we believe the disclosures may result in a limitation on an entity's ability to put forth an optimal legal defense (by providing a counterparty with the estimate).

In summary, we believe if disclosure of quantitative information would be prejudicial, no quantitative disclosures should be required.

- 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?**

We believe in certain situations in which a claim amount is not specified, entities may be unable to provide reliable estimates of maximum exposure to loss. (Such situations would include unasserted claims and early-stage litigation.) Because of the lack of reliability, we believe quantitative disclosures would not be meaningful.

We also believe situations will arise in which the maximum possible exposure to loss will not be a meaningful disclosure. In some situations, the maximum exposure to loss will be very large, but will bear little relation to any ultimate loss amount.

As stated previously, we believe if a specific claim amount is not specified, an entity should only be required to disclose a maximum loss if the loss can be reasonably estimated by the entity and disclosure of that amount would not be prejudicial.

- 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 agree with the Board's conclusion not to require disclosures of settlement offers, for the reasons stated above. Moreover, entities may settle similar lawsuits for different amounts, and we are concerned that disclosing settlement offers in one dispute may be prejudicial with respect to other disputes.

- 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?**

We believe if the disclosed information is not prejudicial, the proposed tabular reconciliation would provide meaningful information. However, we do not see how information that is considered prejudicial would be included in the tabular reconciliation. Specifically, would an entity be permitted to omit such information from the tabular reconciliation? Or does the existence of prejudicial information mean that the entity is not required to include a tabular reconciliation at all?

- 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?**

We agree with the notion of including an exemption from disclosing prejudicial information. However, we believe that much of the information included in the proposed disclosures is prejudicial and, as such, we recommend that the exemption be expanded.

We also believe that making a determination as to whether information is prejudicial is likely to require a significant change in the approach to auditing these disclosures. Accordingly, we recommend that the effective date be deferred.

- 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 the two-step approach attempts to address concerns related to prejudicial information, we are not (nor do we believe the FASB is) in a position to determine the frequency in which such situations will arise. Consequently, we recommend that the ED be amended to remove any references to "rare instances" in which the exemptions may be used.

Furthermore, we struggle to see how the exemption will be utilized with respect to the qualitative disclosures. If entities are permitted to aggregate the qualitative disclosures, how would an entity aggregate on a level higher than by nature of contingency? Also, we feel that even after an entity utilizes the prejudicial exemption, the required qualitative and quantitative disclosures may require that entity to make disclosures that are prejudicial. We believe that requiring entities to disclose the maximum exposure to loss might be prejudicial. Similarly, we believe that requiring entities to provide "a description of factors that are likely to affect the ultimate outcome of the contingency along with the potential impact on the outcome" may also be prejudicial.

- 10. The International Accounting Standards Board (IASB) continues to deliberate changes to IAS 37, Provisions, Contingent Liabilities and Contingent Assets, but have 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?

We support the Board's efforts on convergence with International Financial Reporting Standards. However, with respect to the proposed disclosures that are the subject of this proposed Statement, we believe that the highly litigious environment in the United States might merit a divergence; specifically, we believe that reporting entities in the U.S. may need to avail themselves of the exemption in more cases than do the entities currently applying IAS 37. For that reason, we agree that the exemption should be more readily available in the U.S.

As alluded to in our comments above, however, we do not believe that the circumstances under which prejudicial exemption will need to be exercised are "rare." Therefore, we recommend that the exemption be expanded to be available in more circumstances.

- 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 with the description of prejudicial information.

- 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 believe that requiring the tabular reconciliation on an interim basis would be onerous and, therefore, believe that it should only be included for annual periods.

- 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?**

We believe the disclosures required by the proposed Statement adequately address disclosures for loss contingencies.

- 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?**

We do not believe the proposed effective date is operational, for the reasons included in our previous comments.

We would be pleased to respond to any questions the Board or its staff may have about any of our comments. Please direct questions to either Jay D. Hanson (952-921-7785) or Richard K. Stuart (203-905-5027).

Sincerely,



McGladrey & Pullen, LLP