

Mr. Russell Golden Technical Director Financial Accounting Standards Board 401 Merritt 7, POB 5116 Norwalk, CT 06856 USA



LETTER OF COMMENT NO. 127

File reference No. 1600-100

Dear Mr. Golden.

Japan Tobacco International (JTI) is a wholly-owned subsidiary of Japan Tobacco Inc., the world's third largest international manufacturer of tobacco products. While JTI's international headquarters are located in Europe, we prepare our consolidated financial statements in compliance with US GAAP.

We appreciate the opportunity to comment on the Proposed Statement of Financial Accounting Standards, *Disclosure of Certain Loss Contingencies, an amendment of FASB Statements No. 5 and 141(R).* The following is a brief summary of our comments:

- With respect to ED Question 4, we:
 - Disagree with the requirement to disclose the "entity's best estimate of the maximum exposure to loss"
 - Agree with the current proposal to permit but <u>not require</u> disclosure of the possible loss or range of loss if the entity believes the amount of the claim or assessment is not representative of the entity's actual exposure.

Such disclosures would compromise entities' ability to protect their interests, especially in negotiations to settle a claim.

- With respect to ED Question 7, we disagree with the requirement to disclose acquired loss contingencies separately from "internally generated" loss contingencies. We believe that a separate disclosure would not provide incremental decision-useful information to users of financial statements.
- With respect to paragraph 5.b (2) of the Exposure Draft relating to unasserted claims or assessments, we recommend that the Board retain current terminology in paragraph 10 of FASB Statement 5. Specifically, the Board should not change the term "reasonable possibility that the outcome will be unfavorable" to "the likelihood of a loss... is more than remote." That would help to clarify that the existing disclosure requirement is retained without change.

ED Question 4

Paragraph 7(a) of the Exposure Draft would require disclosure of the "entity's best estimate of the maximum exposure to loss." According to paragraph 11, disclosure



is required even if such a disclosure will detrimentally affect the outcome of the contingency. These provisions together will compromise entities' ability to protect their interests, especially in negotiations to settle a claim.

It often occurs that a claimant does not quantify a claim. In those circumstances, paragraph 7(a) requires the entity to disclose its "best estimate of the maximum exposure to loss." That estimate may be core attorney work product, and thus protected for disclosure in court proceedings. But putting that matter aside, the estimate may also be a critical basis for the entity's opening position in negotiations for settlement of a claim – like a bargaining buyer, an entity considering settlement must have a maximum value in mind. Publicly disclosing that value, such that the other party knows of it, immediately compromises the entity's ability to settle below the maximum amount. In effect, the entity goes into negotiations in which the other party knows how much the entity is willing to pay.

To resolve this problem, the Board should consider removing from paragraph 11 the absolute requirement to disclose the best estimate of maximum exposure. Alternatively, the Board could limit disclosure of exposure amounts to amounts actually offered in settlement or otherwise already disclosed (e.g., through counterparty's public statements).

For the reasons stated above, we also believe that disclosure of the possible loss or range of loss should be permitted but not *required* if the entity believes the amount of the claim or assessment is not representative of the entity's actual exposure (Ouestion 4B).

ED Ouestion 7

We understand paragraph 8 tabular reconciliation requirements to cover all loss contingencies within the scope of FASB Statement 5 and 141(R), including indirect tax exposures. We agree with aggregating all FASB Statement 5 loss contingencies into one tabular reconciliation; however, we disagree with the requirement to disclose separately acquired loss contingencies within the scope of FASB Statement 141(R).

Reporting entities are already required to disclose assets acquired and liabilities assumed in business combinations. In our opinion, that disclosure is sufficient to inform users of loss contingencies that are initially recognized under FASB Statement 141(R) recognition threshold rather than FASB Statement 5 recognition threshold.

The purpose and informational usefulness of disclosing acquired and "internally generated" loss contingencies in separate tables subsequent to the acquisition is not



clear to us. Some of the acquired loss contingencies will subsequently be recognized and measured under FASB Statement 5 (similar to "internally generated" loss contingencies) while other acquired loss contingencies will continue to be recognized and measured under FASB Statement 141(R) as applied at the acquisition date (a different recognition and measurement attribute.) If the table of acquired loss contingencies contains liabilities that are recognized and measured under different models, what additional useful information would users obtain from that separate disclosure (above and beyond what was initially disclosed under FASB Statement 141(R))? Is the purpose of a separate tabular disclosure to show that certain acquired liabilities are less likely to result in outflows of cash (or other economic resources) than "internally generated" liabilities? If so, the objective likely would not be achieved. If the objective is to separate liabilities that were recognized in earnings from those recognized through goodwill, that information is already provided under FASB Statement 141(R).

For these reasons, we recommend that the Board remove the requirement to disclose separately loss contingencies accounted for in accordance with FASB Statement 141(R). That is, all loss contingencies should be disclosed in one table. If that recommendation is not accepted, we encourage the Board to include a clear rationale (informational usefulness) for including a separate table for acquired loss contingencies in the basis for conclusion.

Proposed paragraph 5(b)

Paragraph 10 of the FASB Statement 5 provides that a loss contingency involving an unasserted claim must be disclosed when "it is considered probable that a claim will be asserted and there is a *reasonable possibility* that the outcome will be unfavorable" (emphasis added). The proposed new standard requires entities to disclose unasserted claims whose assertion is probable and as to which "the likelihood of a loss, if the claim or assessment were to be asserted, is *more than remote*." The Basis for Conclusions (paragraph A14) states that the new language is a substantial retention of the FASB Statement 5 standard.

While the terms "reasonably possible" and "more than remote" appear to be interchangeable in the context of FASB Statement 5,¹ legal counsel likely would read new disclosure requirements in the context of the usual general meaning of the above terms. If the term is changed from "reasonably possible" to "more than remote," legal counsel might interpret the new language as an incremental disclosure requirement. To avoid unnecessary confusion, we recommend that the Board retain the existing FASB Statement 5 terminology (i.e., "reasonably possible" rather than "more than remote"). If that recommendation is not accepted, we believe

¹ Reasonably possible means the chance of the future event or events occurring is <u>more than</u> remote but less than likely.



that the Board should clarify the reason for changing the FASB Statement 5 language and its implications for the disclosure requirements.

The following is an example of how the new wording might be read by legal counsel (note that the terms *probable* and *reasonably possible* are used in their usual general meaning):

It appears in fact that the new language broadens the disclosure requirement. In so doing, the proposal makes already difficult compliance nearly impossible and likely encourages useless and speculative overdisclosure.

The reason is that ordinary business activities – selling products, entering agreements, employing workers – necessarily create *arguable* claims from time to time. A distributor will believe its agreement has been wrongfully terminated. A consumer will believe that a product is defective. A competitor will believe that a mark or patent has been infringed. At an entity level, assertion of certain identifiable claims is always probable. Thus, to comply with the letter of the standard, an entity must in effect examine its own arguably illegal conduct and disclose it – but, under the present standard, only if there is a reasonable possibility of a bad outcome. In a prudently operated entity, this limitation will effectively exclude most arguable claims because the entity will have considered legal risks before undertaking an activity.

By comparison, it would be difficult to conclude that the likelihood of a loss from an imagined claim is remote. This is especially the case if the assessment must account for all possibilities of the jurisdiction and legal nature of the claim – a single transaction could give rise to a number of imaginable claims in different places under different legal theories. Even if counsel could opine that all the claims would be weak, *how* weak they are is a matter of guesswork. The effect of the standard then is to force disclosure of speculative contingencies, even in circumstances when it is impossible to supply the information required by paragraph 7 except by imagining it. It is not apparent how such information would assist users in objective valuation of an entity's financial position.

The Board should consider, on the contrary, taking this opportunity to balance users' interest in early warning and users' interest in reliable information by drawing a disclosure bright line: disclosure of unasserted claims should be required when a potential claimant (or other interested party) has manifested an awareness of the potential claim or assessment. This "manifestation" may appear later than when an entity can imagine a claim, but the "manifestation" will always precede a loss and is



likely to provide a more reliable basis on which to assess the risk of loss and to disclose the information required by the proposed paragraph 7.

We thank you for the opportunity to comment and look forward to following the Board's redeliberation of the Exposure Draft. If you have questions, please contact Francois Dugast at 41 22 703 0419 or Jonathan Truelove at 41 22 703 0310.

Best regards,

s/ Marina Sletten
Financial Reporting and Accounting Controller
Director