American Federation of Labor and Congress of Industrial Organizations

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Via Electronic & U.S. Mail

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LETTER OF COMMENT NO. 225

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

File Reference No. 1600-100: Disclosure of Certain Loss Contingencies

Dear Mr. Golden,

On behalf of the American Federation of Labor and Congress of Industrial Organizations ("AFL-CIO"), I appreciate the opportunity to comment on the Financial Accounting Standard Board's efforts to provide investors with more meaningful information about loss contingencies under Statement No. 5.

Union-sponsored pension plans hold more than $450 billion in assets, and union members participate in benefit funds with more than $5 trillion in assets. Collectively, union members and their pension funds have suffered hundreds of billions of dollars in losses as a result of accounting scandals in the last decade, as well as through the manipulation of the timing of stock option grants, and the ongoing mortgage crisis. These losses could have been considerably reduced or avoided had the companies given investors accurate and complete information about the true liabilities in their financial statements.

The AFL-CIO agrees with the Financial Accounting Standards Board ("FASB") that the disclosures under the current Statement 5 "do not provide adequate information to assist users of financial statements in assessing the likelihood, timing, and amount of future cash flows associated with loss contingencies." The board's initiative to expand the disclosures under Statement 5 will also prompt companies to better manage their risks because "what is measured is managed, and what is managed is reduced." But, we believe the Exposure Draft can be further strengthened by closing existing loopholes.

In particular, we are concerned that the Exposure Draft would permit companies in some instances to avoid disclosing the risks of contingent losses if the likelihood of their occurring is "remote".[1] Ultimately, this approach to disclosure will result in more unpleasant surprises for investors as companies continue to underestimate the likelihood of financial risks. The collapse of Bear Stearns Cos., as well as the taxpayer-funded bailout of the Federal National Mortgage Association and the Federal Home Mortgage Association, are all prime examples of the failure of companies to disclose financial risks in a timely manner because they regarded them as remote.

Furthermore, the Exposure Draft requires companies to disclose contingency losses, regardless of their probability of occurring, if they "are expected to be resolved in the near term" and could have "a severe impact" on the financial position, cash flows, or results of operation.[2] But the risks that led to the mortgage crisis and the collapse of Long-Term Capital Management and Enron existed for many years, and did not develop overnight. The AFL-CIO therefore suggests that FAS 5 should require companies to disclose all meaningful financial threats, regardless of how long it takes to resolve them.

We also believe that Paragraph 6 should be amended to cover losses that have a "material" impact on the operations of a company, rather than "severe impact," as adopted by the Statement of Position 94-6 (SOP) or the "Disclosure of Certain Significant Risks and Uncertainties." The accounting rule clearly failed to protect investors during the corporate scandals that brought down Bear Stearns and other companies, and needs to be replaced with a standard that will better serve investors.

We also agree with comments by other investors that companies should provide timely, relevant and reliable information about the potential magnitude of liabilities and losses, as well as the timing of payments arising from contingencies. It is important that investors receive all the material information necessary to make informed decisions about where to allocate their capital. It would be wrong for a company facing a material impact from a contingency to withhold that information from investors, causing them to overpay for the investment. This is consistent with the FASB's own conceptual framework that notes the importance of neutrality in financial reporting.

The AFL-CIO also believes that companies should be required to disclose to investors a description and value of outstanding claims against them, the status of the claims, as well as the likelihood of prevailing in court.

[1] FAS 5 Exposure Draft, Paragraph 5.
[2] FAS 5 Exposure Draft, Paragraph 6.

Under the FASB proposal, companies would be allowed to avoid many disclosures by having their lawyers argue that the publication of information would be "prejudicial." We oppose this vague standard that we believe would be routinely abused. Companies anticipating litigation, such as pharmaceutical companies aware of the harmful side-effects caused by a drug not yet recalled from the market, must present the full facts to investors in order for them to make the right investment decision.

We have seen far too many situations where the managers were aware of impending litigation yet left investors in the dark. Where it is not possible for companies to estimate the value of the legal claims against them, they should disclose their best estimate, or as much information as is possible to give investors an idea of the type, nature, and magnitude of the risks they face.

We appreciate the opportunity to present our views on this important matter. If the AFL-CIO can be of further assistance, please do not hesitate to contact me at (202) 637-5379.

Sincerely,

Daniel Pedrotty
Director, Office of Investment

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