

The Association for Accountants and Financial Professionals in Business

September 26, 2010

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

File Reference No. 1840-100

The Financial Reporting Committee of the Institute of Management Accountants ("we" or "FRC") is writing to provide its views on the Financial Accounting Standards Board's (FASB) Proposed Accounting Standards Update Contingencies (Topic 450), Disclosure of Certain Loss Contingencies, (the "proposed ASU") dated July 20, 2010.

FRC is the financial reporting technical committee of the IMA. The committee includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics and analysts. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations.

We support the Board's objective of enhancing the required disclosures of certain loss contingencies to enable financial statement users to understand their nature, potential magnitude and potential timing. We commend the Board on the due process efforts that it undertook as part of its project on disclosures of certain loss contingencies. The Board demonstrated a strong commitment to engaging its constituents and bringing together a broad range of stakeholders including preparers, users, legal counsel and auditors to provide input during its deliberations process. The feedback received as a result of this comprehensive outreach is evident in several of the decisions that have been incorporated in the proposed ASU. In our view, a number of the revisions to the required quantitative and qualitative disclosures demonstrate the value of effective due process.

We are concerned, however, that the Board continues to add disclosure requirements on an ad hoc basis. The Board has recently added a disclosure framework project to its agenda, acknowledging a need for an overarching framework that will make financial statement disclosures more effective, coordinated, and less redundant. Yet this project, in addition to others, is progressing on an accelerated timeline without regard either to an overall conceptual framework or practical limitations on footnote disclosures. We encourage the Board to consider whether continuing in this vein is consistent with its

10 Paragon Drive Suite 1 Montvale, NJ 07645 www.imanet.org overall objectives. In addition, we do have concerns with certain of the proposed requirements, both in terms of the potential for prejudicial disclosures and whether the provisions are operational.

During its deliberations, the Board had tentatively concluded to focus disclosure requirements on publicly available information. Although this concept was incorporated into certain aspects of the proposed ASU, it is not articulated as an overall disclosure principle nor followed consistently in the proposed disclosure requirements. We believe that doing so would alleviate confusion and concern with certain required qualitative and quantitative disclosures.

We note that the Board has eliminated many of the predictive and speculative disclosures previously proposed; however, factual information that is not publicly available has the potential to be prejudicial if prematurely disclosed. We believe that certain of the proposed disclosures and certain aspects of the tabular reconciliation, both of which could provide information not otherwise available to the general public, would be prejudicial in nature. We do not believe that the ability to aggregate disclosures about similar contingencies will always alleviate these concerns and therefore strongly recommend that the Board reconsider the need for a prejudicial exemption.

We do not believe that the disclosures of certain asserted but remote loss contingencies should be required for several reasons:

- It is not clear that these disclosures will be useful to investors and, in fact, we believe that disclosures of this nature could distract users from the more meaningful information regarding probable and reasonably possible losses. In our experience, users of financial statements do not consider events that are remote as material, even if the events could theoretically have a severe impact. Moreover, disclosures about contingencies with a remote likelihood of loss are generally based on information that is preliminary, highly uncertain and therefore, potentially misleading to users.
- In some instances, the asserted but remote loss contingencies may involve litigation. Currently the "Treaty" between the American Bar Association (ABA) and the AICPA governs legal counsel's responses to auditors. These responses are the auditors' primary means of corroborating information provided by management with regard to loss contingencies arising from litigation. However, the responses are generally limited to information concerning matters for which the lawyer has devoted substantive attention; asserted but remote litigation contingencies may not meet this criterion. Also, legal counsel may not view these contingencies as meeting their threshold of 'materiality' as defined by the courts due to their remote nature. As a result, auditors may have to rely on in-house counsel's representations with regard to the existence of asserted but remote contingencies.
- We believe that there will be considerable uncertainty as to when asserted but remote
 contingencies meet the disclosure threshold of 'severe impact.' The determination of whether a
 potential impact could be severe would appear to require predictions of outcomes; this is
 contradictory to the Board's decision not to require new disclosures based on management's
 prediction about a contingency's resolution. Further, as the reporting entity already has
 assessed the risk of loss to be remote, it is not clear how the reporting entity would determine

whether the potential impact is severe, if not simply based on the claim amount. Absent more specific implementation guidance that clarifies the Board's intent or provides specific examples, this requirement is likely to result in confusion as to whether incremental disclosures are required.

As proposed, an entity would never be permitted to consider the possibility of recoveries from insurance or other indemnification arrangements when assessing the materiality of loss contingencies for disclosure. We strongly disagree as we believe that users of financial statements would not assess litigation of a specified magnitude that is expected to be fully reimbursed by insurance coverage the same way as a contingency of the same magnitude that is not covered by insurance. As a result, we believe that insurance recoveries should be netted in assessing materiality of an asserted claim for disclosure, unless there is significant uncertainty about whether the insurer is liable or there is reason to believe that the insurer will be unable to perform. We would not expect that users of financial statements are interested in voluminous disclosures regarding contingent liabilities which the entity fully expects to recover from insurance carriers. As the likelihood of recovery increases, the gross amount of the contingent liability is of diminishing interest to users in understanding the entity's level of risk and liquidity. We therefore believe that the disclosure threshold should incorporate consideration of insurance recoveries and other indemnification agreements when there is little or no uncertainty (e.g., when recovery from the insurer is probable).

In addition to concerns with specific disclosure requirements, some of which we address in the following appendix in response to the Board's detailed questions, we believe that the effective date proposed is onerous. The nature of contingencies requires a manual process to identify and analyze information that may require disclosure. Particularly in large global entities that operate in multiple legal jurisdictions, this is a time-consuming process for which the proposed amendments would require a significant incremental effort, extensive internal analysis and management judgment. We therefore recommend that the Board require adoption for both public and nonpublic entities for fiscal years ending after December 15, 2011.

We appreciate the Board's consideration of these comments. We are available to discuss these matters at your convenience.

Allan Cohen

Chairman, Financial Reporting Committee Institute of Management Accountants

Appendix

Responses to questions in the Proposed ASU, Contingencies (Topic 450), Disclosure of Certain Loss Contingencies

Question 1: Are the proposed disclosures operational? If not, please explain why.

We believe that the disclosure principles provide an appropriate, broad framework for the disclosure of certain loss contingencies. However, we are concerned whether some of the specific disclosure provisions are operational, either because the requirements would result in the incurrence of extensive cost for preparers or the wording is ambiguous.

The overall cost to preparers for complying with many of the new disclosure requirements in this proposal will be extensive. Entities will be required to implement processes and policies to compile and assess new qualitative and quantitative information related to all asserted contingencies, as well as to evaluate all asserted remote contingencies for potential severe impact. For public entities, this would also entail the design and implementation of new internal control processes meeting Sarbanes-Oxley Act (SOA) 404 standards. We believe that it is imperative for the Board to be able to demonstrate, for each new disclosure requirement, that there is an appropriate balance between the benefit to users and the expected costs to preparers.

We believe that there will be considerable uncertainty as to when asserted but remote contingencies meet the disclosure threshold of 'severe impact.' The determination of whether a potential impact could be severe would appear to require predictions of outcomes; this is contradictory to the Board's decision not to require new disclosures based on management's prediction about a contingency's resolution. Further, as the reporting entity already has assessed the risk of loss to be remote, it is not clear how the reporting entity would determine whether the potential impact is severe, if not simply based on the claim amount. Absent more specific implementation guidance that clarifies the Board's intent or provides specific examples, this requirement is likely to result in confusion as to whether incremental disclosures are required.

The proposed ASU requires a tabular reconciliation by class for both interim and annual reporting periods. We believe it would be extremely difficult for preparers to compile this information as much of it is tracked manually or in multiple off-line repositories or systems. Any holistic reporting of this nature would require a significant administrative effort that could far exceed the benefit of this disclosure to users. To the extent that the recognized loss contingencies are material, the proposed ASU requires substantive quantitative and qualitative disclosures. The tabular reconciliation would serve only to aggregate these with those that are not material. Moreover, the level of disaggregation of the disclosure of components of changes in liabilities proposed is inconsistent with that currently provided in similar analyses required by other US GAAP which require reconciliations at a more summarized level (e.g., ASC 460, *Guarantees*, does not require that the disclosure of changes in estimates for warranties be disaggregated between increases and decreases).

If the Board determines that the benefit of a tabular reconciliation to users is significant enough to warrant the costs to preparers (including the risk of disclosing prejudicial information, as discussed in response to Question 3), we strongly encourage reconsideration of the incremental value of this disclosure in interim reports. In accordance with ASC 260-10-50-6 and Article 10 of Regulation S-X, an entity is already required to provide disclosure of material contingencies even though a significant change since year end may not have occurred. Moreover, due to the non-systemic nature of the process to compile this information and the tight timing for quarterly reporting, compliance with interim requirements would be particularly burdensome to preparers, creating further imbalance between the cost to preparers and benefit to users.

The proposed ASU includes an example that illustrates various disclosure requirements for a single breach of contract case. In practice, preparers with numerous contingent liabilities, including disparate litigation, would benefit from a more comprehensive example. We suggest that the Board include a more realistic example to help those entities understand how to aggregate qualitative and quantitative disclosures to meet the proposed disclosure objectives. In addition, the example should only include disclosure information that would be required by the guidance. For instance, we noted that the example in proposed paragraph 55-42 includes a statement that the "loss related to this matter is probable"; as this is not a required disclosure, it is unlikely that an entity would choose to provide that information.

The broad scope of these disclosure requirements concerns us as well. The current proposal retains the scope of ASC 450-20 which is applicable to all loss contingencies unless specifically excluded. Accordingly, based on the guidance in ASC 450, the new disclosure requirements would apply to, but not be limited to, the following types of contingencies:

Asset impairments and agreement to assume liabilities:

- Collectibility of receivables
- Risk of loss from catastrophes assumed by property and casualty insurance entities including reinsurance entities
- Guarantees of indebtedness of others
- Obligations of commercial banks under standby letters of credit
- Agreements to repurchase receivables (or to repurchase the related property) that have been sold
- Risk of loss or damage of property by fire, explosion, or other hazards
- Threat of expropriation of assets

Claims against the entity's based on the entities actions, products or services:

- Obligations related to product warranties and product defects
- Injury or damage caused by products sold
- Actual or possible claims and assessments
- Pending or threatened litigation

We note that the 2008 Exposure Draft would have limited the applicability of this guidance to certain contingent liabilities, and would have excluded asset impairments and guarantees within the scope of FIN 45, Guaranter's Accounting and Disclosure Requirements for Guarantees, Including Indirect

Guarantees of Indebtedness of Others. We continue to believe that the scope of the disclosure requirements should be more limited, specifically to the disclosures in the second group of contingencies described above.

Question 2: Are the proposed disclosures auditable? If not, please explain why.

We are concerned with the ability to audit disclosures related to asserted but remote contingencies. Currently the "Treaty" between the ABA and the AICPA governs legal counsel's responses to auditors. These responses are the auditors' primary means of corroborating information provided by management with regard to loss contingencies arising from litigation. However, the responses are generally limited to information concerning matters for which the lawyer has devoted substantive attention; asserted but remote litigation contingencies may not meet this criterion. Also, legal counsel may not view these contingencies as meeting their threshold of 'materiality' as defined by the courts due to their remote nature. As a result, auditors may have to rely on in-house counsel's representations with regard to the existence of asserted but remote contingencies.

Question 3: The June 2008 FASB Exposure Draft, *Disclosure of Certain Loss Contingencies*, had proposed certain disclosures based on management's predictions about a contingency's resolution. The amendments in this proposed Update would eliminate those disclosure requirements such as estimating when a loss contingency would be resolved and the entity's maximum exposure to loss. Do you agree that an explicit exemption from disclosing information that is "prejudicial" to the reporting entity is not necessary because the amendments in this proposed Update would:

- a. Not require any new disclosures based on management's predictions about a contingency's resolution
- b. Generally focus on information that is publicly available
- c. Relate to amounts already accrued in the financial statements
- d. Permit information to be presented on an aggregated basis with other similar loss contingencies?

If not, please explain why.

During its deliberations, the Board had tentatively concluded to focus disclosure requirements on publicly available information. The Board has eliminated many of the predictive and speculative disclosures previously proposed; however, factual information that is not publicly available has the potential to be prejudicial if prematurely disclosed. We do not believe that the ability to aggregate disclosures about similar contingencies will always alleviate these concerns and therefore strongly recommend that the Board reconsider the need for a prejudicial exemption.

Some of the proposed qualitative disclosures specify that the requirement is contingent on the information being publicly available. Other requirements, such as those in ASC 450-20-50-1Fb, are not clearly limited to information that is publicly available. The disclosures in this paragraph require disclosure of contentions of the parties, such as basis for the claim, amount of damages claimed by the

plaintiff, the basis for the entity's defense and anticipated timing in the resolution of a material contingency, but it is not clear whether this information must be disclosed if the information is not publicly available and perhaps known only to the reporting entity and the plaintiff. Our understanding is that information may be provided to the plaintiff under specific protections of law so that the information will not become publicly available and thereby prejudice the entity. In addition, the disclosure of possible recoveries would be required in certain instances when the information is not publicly available. We believe that disclosing such information when it is not publicly available could be prejudicial to the reporting entity, and in fact, could result in additional claims being filed against the entity. Moreover, requiring an entity to disclose information that will be discoverable at a future date poses concerns as well. The rules of discovery are complex, jurisdictional and structured such that the sequencing of information provided is critical to an equitable legal process. We believe that requiring disclosure of this information before required by the legal process could be prejudicial.

The proposal would require disclosure of the amount accrued. Currently, this disclosure is only required when it is necessary for the financial statements not to be misleading. While the current requirement allows an entity to use prudent judgment in determining whether such a disclosure is needed, the proposal would require disclosure of the accrual in all circumstances. In many cases, this information clearly would be prejudicial to an entity. The amount accrued is a reflection of an entity's internal assessment of a loss contingency's potential outcome. In combination with the tabular reconciliation requirement (discussed further below), the disclosure would provide a roadmap to an entity's continuing evaluation of its exposure to a specific contingency. In many instances, the allowable level of aggregation would not adequately mitigate the risk of prejudice from these disclosures. We therefore believe that the current language related to disclosure of amounts accrued should be retained.

We are concerned that the requirement to provide a tabular reconciliation by class of recognized loss contingencies would in some instances result in the disclosure of prejudicial information. Many types of contingencies do not lend themselves to aggregation by class and therefore compliance with these provisions would result in significant disaggregation. As a result, the disclosures, especially the required descriptions of significant activity, may provide information to a plaintiff (or potential plaintiff) that otherwise would not be available. Moreover, in general, we believe that aggregation would not be sufficient to protect an entity from disclosing prejudicial information when there is a single claim that is significant in relation to the entity's other loss contingencies.

While we have noted several concerns related to the lack of a prejudicial exemption, we are aware that our understanding of, and expertise in, the legal system is limited. We encourage the Board to carefully consider comments from attorneys, and groups consisting of attorneys, who are proficient in these areas. It is clearly not the Board's intention to require disclosures that could pose new risks to the entity or those that would be misleading to users. For this reason, it is critical that the proposed disclosures be thoroughly vetted with those who have a complete understanding of the legal environment.

Question 4: Is the proposed effective date operational? If not, please explain why.

We believe that the effective date as proposed would be onerous to preparers. The nature of contingencies requires a manual process to identify and analyze information that may require disclosure. Particularly in large global entities that operate in multiple legal jurisdictions, this is a time-consuming process for which the proposed amendments would require a significant incremental effort. New processes may have to be implemented for the identification and analysis of the potential impact of asserted remote loss contingencies and the disaggregation of accrual activity for the tabular reconciliation. Entities will need to determine appropriate aggregation policies to provide meaningful, informative disclosure that is not overwhelming in detail, which may require assessments of a significant volume of contingencies. Implementation of the proposed requirements would thus require significant internal analysis and judgments in several new areas. In addition, public entities would be required to design and implement related internal control processes that comply with the SOA Section 404, and those internal controls would have to be tested by independent auditors for larger public companies. We therefore recommend that the Board require adoption for both public and nonpublic entities for fiscal years ending after December 15, 2011.

Question 5: Do you believe that the proposed disclosures will enhance and improve the information provided to financial statement users about the nature, potential magnitude, and potential timing (if known) of loss contingencies?

We believe that the Board has made significant progress with the proposed disclosures of loss contingencies since its 2008 Exposure Draft. In our view, a number of the revisions to the required quantitative and qualitative disclosures demonstrate that the Board listened to the views and concerns of its stakeholders. In general, we believe that the disclosures would provide useful information to financial statement users about the nature, potential magnitude and potential timing of loss contingencies. However, as noted above, we still have significant concerns with certain of the proposed requirements, both in terms of the potential for prejudicial disclosures and whether the provisions are operational.

Question 6: Do you agree that nonpublic entities should be exempt from the tabular reconciliation disclosures required in the amendments in this proposed Update? If not, please explain why. Are there any other aspects of the amendments that should be applied differently to nonpublic entities? If so, please identify and explain why.

For the reasons described above, we believe that the tabular reconciliation should not be required for any companies.

Question 7: The amendments in this proposed Update would defer the effective date for nonpublic entities for one year. Do you agree with the proposed deferral? If not, please explain why.

As noted above, we believe that public entities will need more time to effectively comply with the new disclosure requirements as well. Accordingly, we believe that the effective date for all entities should be for years ending after December 15, 2011.

Question 8: Do you believe that the proposed and existing XBRL elements are sufficient to meet the Securities and Exchange Commission's requirements to provide financial statement information in the XBRL interactive data format? If not, please explain why.

Based on our limited review, the proposed and existing XBRL elements appear sufficient to meet the requirements to provide financial statement information in the XBRL interactive data format.