



COMMITTEE ON CORPORATE REPORTING

COMMITTEE ON GOVERNMENT BUSINESS

COMMITTEE ON TAXATION

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Financial Accounting Standards Board  
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The Committees on Corporate Reporting, Government Business, and Taxation (“The Committees”) of Financial Executives International (“FEI”) appreciate the opportunity to share their views on the FASB’s proposed Accounting Standards Update *Contingencies (Topic 450), Disclosure of Certain Loss Contingencies*, (the “ED”) dated July 20, 2010.

FEI is a leading international organization of 15,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives and other senior financial executives. The Committee on Corporate Reporting (CCR) is a technical committee of FEI, which reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. The Committee on Government Business (CGB) formulates positions and comments on government policies that impact FEI members doing business with all sectors of the federal government. The Committee on Taxation (COT) formulates tax policy for FEI in line with the views of the membership. This document represents the Committees’ views and not necessarily those of FEI or its members individually.

We first wish to recognize the significant outreach efforts the Board undertook as part of this project and the resulting changes introduced in the revised exposure draft, which represent a demonstrative improvement over the initial ED issued in 2008. That said, there are still important issues that need to be addressed if the Board intends to issue a final package of disclosures on loss contingencies that can be reasonably implemented without creating adverse consequences for companies and their shareholders. We urge the Board to take whatever additional time is necessary to ensure that it has found the right balance between improving disclosures in this area and addressing preparer concerns about adverse consequential effects of the ED’s requirements.

Investors view a company's financial statements as the principal source of information that is critical to achieving an understanding of its present financial condition, past performance and future prospects. In that vein, investors will naturally conclude that any and all disclosures about contingencies provided by the company under this proposed standard are important, accurate, representationally faithful and crucial to an understanding of future results. We believe that the critical remaining flaws in the ED relate to those areas in which disclosures are required for matters that: (a) are unimportant or speculative, (b) appear to lend the company's support for the veracity of the plaintiff's claims (e.g., "the company wouldn't be providing this information if it weren't true"), and (c) compromise the company's legal position by potentially waiving attorney client or attorney work product privilege or revealing sensitive financial information regarding a case. Through its outreach efforts, we believe that the Board learned much about the practical realities of litigation in the United States. In our litigious society, it is reasonable to expect that any and all information provided in a company's financial statements about a specific case will be employed by the attorneys of the plaintiff and positioned as an acknowledgement of fact by the company – tantamount to an admission of culpability for the alleged offenses.

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. The ability to aggregate disclosures about similar contingencies will not always alleviate these concerns and therefore we strongly recommend that the Board reconsider the need for a prejudicial exemption. More specifically, while we note the ED provides in several places for it, to eliminate any preparer or auditor confusion, we recommend that the final standard clearly state that a legitimate prejudicial exemption always trumps the enumerated disclosure requirements.

We offer the following specific recommendations for changes in the ED in order to avoid the adverse consequences of these proposed required disclosures.

(1) Tabular reconciliation requirement. We note that the proposed level of disaggregation in the roll-forward (e.g., newly arising separate from pre-existing and increases in estimate vs. decreases in estimate) is not necessary in meeting the FASB's disclosure objective to enable users to understand the nature, potential magnitude and potential timing of various types of loss contingencies. The ending balance, provision for the period and settlements during the period are fully responsive to the objective. Detailed additions and deductions are unlikely to be useful absent more qualitative information about the related changes in judgment. This leads to excessive detail, much of which may be prejudicial as further described below.

Many types of contingencies are unlikely to be capable of aggregation by class under the proposed guidance and therefore compliance with these provisions would result in significant disaggregation. In general, when US GAAP requirements indicate that something "may not be appropriate" a presumption is created that must be rebutted. For example, by indicating that "it may not be appropriate to group together loss contingencies that have significantly different timing of expected future cash outflows (that is, near term versus longer term)", the Board has created a presumption that could make it very difficult to aggregate thousands of asbestos claims which are very similar in every respect except when they were filed (some filed 5 years ago and within months of being settled and others filed last month and needing 3 to 5 years to go through the review process). In addition, the ED indicates that "it may not be appropriate to aggregate litigation in jurisdictions that have different legal characteristics that could

affect the potential timing or the potential magnitude of the loss”, which appears to create a separate presumption that a company may not aggregate otherwise very similar lawsuits that have been filed in different states. If the intent is to permit aggregation, the series of presumptions that need to be rebutted in order to allow for aggregation creates a very high threshold to overcome.

Based on the foregoing and in general, aggregation will not be sufficient to protect an entity from disclosing prejudicial information, particularly when there is a single claim that is significant in relation to the entity’s other loss contingencies. This exposes the company to a higher risk of discovery about the individual accruals and changes in them over time. And if discovery is granted, the specific information about the company’s provisions for loss could provide plaintiffs with a tactical advantage in settlement negotiations by effectively providing a “floor” for any potential settlement offer. Moreover, since the amount of any accrual is determined based upon the advice of counsel, disclosure of these amounts is tantamount to a waiver of attorney-client privilege covering work product.

Waiver of attorney-client privilege covering work product has been a critical issue for FEI in recent years, especially in the tax arena. In *Textron v. United States*, the U.S. Court of Appeals for the First Circuit ruled that tax accrual work papers, prepared by lawyers for auditors and others, were not protected by the work product privilege. Because of our strong interest, FEI filed a brief as amicus curiae in the court of appeals, and filed a subsequent amicus brief in support of Supreme Court review. Since the Supreme Court denied review in *Textron* and the circuit courts remain split on the issue, the disclosures required by this revised ED could allow adversaries to obtain discovery of a company’s analysis of disputed issues (loss contingencies) that it is required to maintain in order to comply with generally accepted accounting principles. Sound policy dictates that companies should be able to share candid assessments of potential litigation claims (loss contingencies) with their outside auditors, for example, without fear that such information would be accessible by competitors or adversaries.

In addition, we observe that much of the information required to complete the reconciliation would need to be tracked manually or in multiple off-line repositories or systems. Therefore, aggregation of this information would require a significant administrative effort. Additionally, the effort to amalgamate it into a meaningful disclosure that is not prejudicial would be extremely difficult. To the extent that the recognized loss contingencies are material, the proposed ASU already requires substantive quantitative and qualitative disclosures. The tabular reconciliation would serve only to aggregate these with others that are not material.

If the Board decides in favor of requiring this disclosure, despite our objections, we request that such information not be required to be included in interim reports but on an annual basis only. In accordance with ASC 270-10-50-6 and Article 10 of Regulation S-X, an entity is already required on an interim basis to provide disclosure of material contingencies even though significant changes since year-end may not have occurred. In our view, requiring the tabular reconciliation in interim periods would not provide significant incremental benefits and would significantly increase the volume of disclosure (four additional tables: current and prior quarter and current and prior year to date, in addition to the required narrative) and complexity of application (e.g., issues such as how to reflect contingencies that arise in one quarter and are settled in a subsequent

quarter). Moreover, due to the nature of the process to compile this information and the tight timing for quarterly reporting, compliance with the proposed interim requirements would be particularly burdensome to preparers and would provide little, if any, incremental benefit to investors compared to existing interim disclosures in this area.

In addition, with regard to the provision that would allow companies to provide disclosures on an aggregated basis, we do not believe it is appropriate to require disclosure of the “average amount claimed” or the “average settlement amount” if a company provides such aggregated disclosures. By their very nature, these two items of information do not provide relevant insights to financial statement users with regard to the company’s loss contingencies. The amounts of plaintiffs’ claims are often greatly exaggerated, and plaintiffs’ counsel would likely concede that very few cases are settled for, or receive court awards near, the original amount of damages claimed. In addition, financial statement users will most likely assume that the reason that companies are disclosing the average settlement amount is because it is indicative of the company’s exposure on the remaining claims when, in fact, the company’s remaining exposures could be well above or well below the average depending on the specific cases at issue. In short, if this information is disclosed, users will reasonably assume that the company is suggesting that it provides some guidance or indication to financial statement users about the company’s exposure on the aggregated claims; since this is clearly not the case, this information will only serve to mislead financial statement users and expose the company to possible claims from its shareholders.

(2) Remote loss contingencies. Most asserted but remote contingencies generally will not meet the disclosure threshold of ‘severe impact’. Nonetheless, preparers will be required to implement processes and policies to evaluate all asserted remote contingencies based on these criteria, incurring cost and effort for what we believe is little benefit. For public entities, this would entail the design and implementation of new internal control processes meeting Sarbanes-Oxley Act (SOX) 404 standards. For remote loss contingencies that result from litigation, we have the following additional concerns:

- As discussed above, investors will assume that the disclosure of these contingencies is important despite the fact the matter is, in fact, remote in likelihood. This will 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. Stated differently, long standing practice in the 35 years since FAS No. 5 was written, has generally not resulted in consequential disclosures about remote contingencies and therefore users should be expected to interpret any new disclosures about contingencies as being at least ‘reasonably possible of loss’ in nature. We are very concerned that this user mindset will not change in the near term.
- There will be collateral consequences for the current treaty between the American Bar Association and the AICPA governing legal counsels’ responses to auditors. Currently, such communications are generally limited to information concerning matters for which the lawyer has devoted substantive attention; asserted but remote litigation contingencies are unlikely to meet this criterion. Also, legal counsel may not view these contingencies as meeting the threshold of ‘materiality’ as defined by the courts due to their remote nature. As a result, auditors may have to rely on management’s representations with regard to the disclosure of asserted but remote contingencies.

- It is quite possible that disclosure of remote contingencies may actually increase the number of non-substantive, frivolous suits (or the threat thereof). At present, companies have the ability to deal with such suits privately. The proposed requirement would provide incentives to trial lawyers to seek additional potential plaintiffs in order to force the disclosure or extract a more substantial settlement. Consider, for example, a nuisance suit related to any form of employment discrimination or product liability. At present, companies would not disclose the details of these if they are without merit and remote. However, we would expect plaintiffs' attorneys to make full use of any device available to them to compel a potentially high-profile disclosure or otherwise benefit financially from the threat of being able to compel one.

(3) Estimates about Possible Loss or Range of Loss for Probable or Reasonably Possible Loss Contingencies. We acknowledge that the proposed requirement to disclose estimates about the possible loss or range of loss exists in current GAAP. However, similar to our concern noted above about disclosure of accrual amounts, if companies are required to disclose specific information about their estimates about possible loss or range of loss, this could provide plaintiffs with tactical advantages in settlement by providing a "floor" for settlement offers they would consider. In addition, because those estimates would be based upon the advice of counsel, we are concerned this disclosure of such information could be found to have constituted a waiver of attorney-client privilege covering work product.

(4) Prejudicial exemption. We acknowledge and appreciate that the Board has eliminated many of the predictive and speculative disclosures previously proposed; however, certain of the information required under the revised ED has the potential to be prejudicial if prematurely disclosed, particularly in a litigious environment. The ED requires 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. Under these requirements, companies will be required to publicize in their financial statements, the damage claims endorsed by testifying experts retained by the plaintiff without regard to how speculative or baseless those claims may be. By including them in the financial statements, the company appears to be assigning them instant credibility and importance from the perspective of the most ordinary investors. In addition, the disclosure of possible recoveries would be required in certain instances when the information is not publicly available.

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. Requiring disclosure of this information to the public or other potential litigants before it is required in the ordinary course of litigation could prove adverse to a company's legal position. As discussed above, the ability to aggregate disclosures about similar contingencies will not always alleviate these concerns and we therefore strongly recommend that the Board reconsider the need for a prejudicial exemption.

(5) Consideration of insurance recoverables. We do not agree with the Board's decision to establish a blanket prohibition on considering insurance or indemnification recoveries in determining whether a contingency should be disclosed under the ED. The ED cites some commenters' views that insurance coverage is often "uncertain" and may be subject to litigation with the insurer. This fails to acknowledge the central role of

insurance in risk management and timely claims resolution. Indemnifications have become a key element of commercial transactions on which all parties rely in evaluating a transaction and the resulting risk of loss. To ignore this business reality distorts the picture of a company's exposure. Moreover, loss contingencies are themselves uncertain; it seems inappropriately asymmetric to exclude consideration of these common mitigating factors on the grounds that they are also contingent. In a standard that relies on the result of a thorough consideration of all relevant facts, it is hard to understand the basis for categorically excluding consideration of these recoveries in determining what needs to be disclosed. Rather, it would be appropriate to require careful consideration of the likely timing and magnitude of recoveries, as well as factors that may prevent or delay them in whole or in part. Absent concerns about whether the underlying event is covered or the ability of the counterparty to perform, we can see no legitimate reason why these mitigants should be ignored in the analysis. We believe that the ED inappropriately adds to the volume of disclosure and fails to differentiate between these types of contingencies from others for which such recoveries are not available.

(6) Scope. Many companies have large, well-established self-insurance programs that appear to be within the scope of the ED. However, the ED excludes insurance companies from its scope. Assuming a self-insurance program is well controlled and following current accounting principles, it appears self insuring companies will be subject to different disclosure requirements versus the rest of the insurance industry. Since the Board concluded, appropriately in our opinion, that insurance companies should, for the most part, be out of scope we believe it is also appropriate to exclude the self-insurance programs of reporting companies from the ED's scope as well.

(7) Contract disputes with the U.S. government. Companies who are contractors for the U.S. Government are subject to compliance with Cost Accounting Standards Regulations and Federal Acquisition Regulations in addition to the financial accounting standards. Disputes regarding differences in interpretation of these additional regulations which impact government contracts are not uncommon and are often resolved through negotiation or litigation. Either method of resolution is generally lengthy and unpredictable in both timing and outcome, such that disclosure as proposed in the ED would be difficult, if not impossible, to meaningfully predict. In addition, disclosure of disputed items could be prejudicial to their outcome.

(8) Publicly available information. We believe that more specificity should be provided as to what constitutes publicly available information subject to the disclosure requirements. There are varying interpretations, based on the wording in the ED, as to whether that is limited to the information released by the relevant court (or ruling body) or information that is otherwise available regardless of source or the accuracy or reliability of what is being provided.

(9) Proposed effective date. Given the timing of the ED and the likelihood that a final standard will not be published until late Fall, we believe that the earliest a final standard could be required to be effective would be for 2011 calendar year-end reporting. Adoption of the standard will require new processes that will have to be implemented for: (a) the identification and analysis of the potential impact of remote contingencies since these are logically not a routine focus of management, (b) disaggregation of accrual adjustments into the numerous line items required by the tabular reconciliation, (c) determination of how to apply the aggregation criteria for the first time, and (d) the initial drafting of meaningful disclosures that are intended to be informative without being

overwhelming. We remind the Board of our earlier comments regarding the implications of this proposal on SOX controls – implementation and testing the design and operational effectiveness of controls in the fourth quarter has always been difficult, especially addressing any concerns the auditors may have. Moreover, adoption requires more than just implementing systems for gathering available information and related controls: to meet the disclosure objective, significant internal analysis and judgment are required, including judgments in several new areas such as ‘special remote contingencies’ (par. 450-20-50-1D) and aggregation (par. 450-20-55-1B). We also observe that some information is not readily available. Most companies do not normally accumulate changes in accrual balances using the kind of disaggregation called for in the reconciliation. The ED acknowledges this difficulty when it says that gathering the information for prior years might not be practicable (BC46). However, company’s data collection routines in 2010 are unlikely to have changed from those used in 2009 with regard to information needed to comply with the proposed standard. Thus, gathering current year details in the fourth quarter of 2010 is likely to be just as impracticable as gathering prior year details.

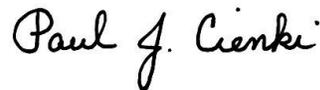
The nature of contingencies requires a manual process to identify and analyze information that may require disclosure. Particularly in large global entities that operate in multiple legal jurisdictions, this is a time-consuming process that requires close coordination between the legal and environmental functions with financial reporting personnel. We note that in consideration of the burden imposed by this standard, the Board has already provided a later effective date for non-public companies. We strongly recommend that the Board provide the same accommodation for public companies by requiring adoption for annual financial statements in fiscal years beginning after December 15, 2010. Quite the contrary, if anyone is in need of a delayed effective date it is large global corporations who by their very nature will normally have larger and more complex contingencies than smaller companies. We would support permitting early adoption of the disclosures by companies that believe they have systems and controls that enable them to do so.

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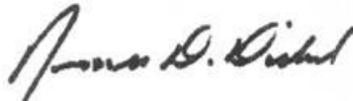
We appreciate the Board’s consideration of these comments. We are available to discuss these matters at your convenience.



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