January 6, 2006

Via e-mail: director@fasb.org

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

Re: File Reference 1235-001 - Invitation to Comment – Selected Issues Relating to Assets and Liabilities with Uncertainties

Dear Director:

This letter is submitted by the undersigned attorneys, all of whom are active members of the Committee on Law and Accounting of the American Bar Association’s Section of Business Law. We are writing to respond to the invitation of the Financial Accounting Standards Board (“FASB”) to comment on the above-referenced Invitation to Comment.

The comments expressed in this letter represent the views of the individuals listed below and have not been approved by the House of Delegates or Board of Governors of the American Bar Association (“ABA”) and therefore do not represent the official position of the Association. In addition, this letter does not represent the official position of the ABA Section of Business Law or any of its Committees, or of any other ABA Section.

I. Introduction

The FASB has requested comments on certain issues set forth in the Exposure Draft of Proposed Amendments to IAS 37 Provisions, Contingent Assets; and IAS 19 Employee Benefits (the “Exposure Draft”) issued by the International Accounting Standards Board (“IASB”). By letter dated October 26, 2005, the ABA’s Law and Accounting Committee submitted a letter of comments to the IASB on its proposal relating to the elimination of the term “contingent liability” and the measurement of liabilities. (Attached is a copy of the comment letter.) We are submitting this letter in light of the request in the Invitation to Comment for comments on these issues, among others.

The Law and Accounting Committee noted in its comment letter to the IASB that it was concerned that the IASB’s proposal failed to take into account the United States legal system under which, unfortunately, frivolous lawsuits are far too common. Furthermore, the IASB would require that liabilities be recorded at their fair value and marked-to-market at each balance sheet date, a process not only complicated and highly judgmental, but extremely time-consuming.

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There follow our responses to the questions posed in the FASB’s Invitation to Comment as well as our comment on the IASB’s proposal regarding disclosure about non-financial liabilities.

II. Specific Questions

Question 5: Do you agree with eliminating the notion of contingent liability? If not, why not?

We do not agree with the proposal to eliminate the notion of contingent liability resulting from pending or threatened litigation. While an entity that has been sued will, of course, respond to such litigation, that does not mean that there is an obligation that should be treated as a present liability recognized in the entity’s financial statements. Moreover, we do not agree with the IASB’s view that a liability always exists in connection with a legal proceeding because the defendant “stands ready” to perform as directed by the court. This view does not give consideration to the fact that lawsuits are a part of doing business in the United States. Tort laws in the United States permit the filing of frivolous lawsuits, and cases are often dismissed before going to trial. To suggest that a liability be recorded in every case ignores the frivolous nature of many these lawsuits. Furthermore, in a jury trial, a jury could construe the recording of a settlement value on the balance sheet as an admission of culpability. Finally, the need for recognition of a liability resulting from the mere filing of litigation in which an entity is named as a defendant is likely to increase the strategic use of litigation and, the threat of litigation. An increase in litigation would be an undesirable consequence of an accounting requirement that litigation require recognition of a liability. To avoid the need to try to quantify a liability resulting from being named as a defendant in litigation, a company may settle a threat of litigation before the litigation is filed.

Question 9: Do you agree with the proposed measurement requirements for nonfinancial liabilities? If not, why not?

We do not agree with the proposal to require an entity to measure the liability resulting from its having been sued at the entity’s best estimate of the amount that the entity would rationally pay to settle the lawsuit or transfer it to a third party on the balance sheet date. Since the transfer by a defendant of the liability resulting from the filing of the lawsuit to a third party is not likely to be possible, the entity would either have to guess at a settlement amount or use an expected cash flow estimation technique to measure the liability.

Typically, when an entity is served in litigation, it is not likely to have a basis for determining whether it should settle the lawsuit at any particular settlement amount, or whether it may ultimately succeed in the litigation. Therefore, under the IASB’s proposal, most entities would need to use the estimated cash flow technique to measure the liability. Such expected cash flow estimation technique is intended to achieve an
amount that reflects the likelihood, amount and timing of the expected cash flows related to the litigation. Presumably, that assessment would require highly subjective judgments as to the amount of likely legal services required and the time period for those legal services, which could be very protracted, even when an entity believes that it would ultimately achieve a positive outcome on the litigation. Generally, in the United States litigation takes a long period of time, during which many developments can have significant impacts on the course of the litigation. Those uncertainties are difficult, if not impossible, to predict.

It is our view that the current requirements of Statement of Financial Accounting Standards No. 5 ("FAS 5") adequately provide for the identification and recognition of liabilities resulting from litigation. If an adverse outcome to litigation is considered to be probable, the estimation of the probable losses relating to such litigation may be difficult, but is justified by the probable loss. If, on the other hand, an adverse outcome to litigation is not considered to be probable, the difficulties of the subjective process by which cash flows would be estimated, as required by the IASB's proposal, would outweigh the benefits of the recognition of amounts that are so uncertain, and likely to be actually paid over an extended period of time.

The Exposure Draft also states that, in the "extremely rare" cases in which an entity cannot reliably measure a non-financial liability, the liability will not qualify for recognition. We do not believe that these cases will be "extremely rare" in view of the litigation environment in the United States. In our view, often defendants are not likely to be able to reliably measure the liability resulting from the filing of the lawsuit. Lawsuits may not be sufficiently precise at the time of the initial filing for the entity to be able to assess the merits of the plaintiff's case. Yet, even if the defendant were to believe that the claims were frivolous, the defendant would have to carefully document its assessment of the likely cash flows to comply with the IASB's proposal. Again, when an adverse outcome to the litigation is not considered to be probable, the burdens of that exercise appear to outweigh the benefits of the recognition of a liability.

III. Disclosure

The IASB's Exposure Draft proposes to require an entity to 1) present for any class of liability with estimation uncertainty certain disclosure required by the current IAS 37, and 2) disclose if a non-financial liability is not recognized because it cannot be measured reliably. In addition, the Exposure Draft proposes an exemption to these disclosure requirements by stating that in "extremely rare cases," an entity need not disclose some or all of the information required by these provisions if it can be expected to seriously prejudice the entity's position in a dispute with other parties on the subject matter of the obligation. In such cases, the entity need only disclose the general nature of the dispute and the reason why the information has not been disclosed. We are concerned that the
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IASB's exemption is too restrictive due to its reference to "extremely rare cases" and its failure to cover paragraph 67 of the Disclosure section of the Exposure Draft. This paragraph proposes to require an entity to present the carrying amount of each class of liability at the period end together with a description of the obligation. That disclosure would adversely affect defendants' litigation position by disclosing settlement positions that plaintiffs could use to their advantage. The reference to "extremely rare cases" should be eliminated and litigants should be protected from disclosing the carrying amount of the liability at the period end.

* * * * *

We hope these comments are helpful. We would be pleased to discuss the foregoing concerns with the FASB or its staff.

Respectfully submitted,

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October 26, 2005

Via e-mail: commentletters@iasb.org

Mr. Henry Rees
Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Re: Exposure Draft of Proposed Amendments to IAS 37 Provisions, Contingent Assets; and IAS 19 Employee Benefits

Dear Mr. Rees:

This letter is submitted on behalf of the Committee on Law and Accounting of the American Bar Association’s Section of Business Law (the “Committee”) in response to the invitation of the International Accounting Standards Board (“IASB”) to comment on the above-referenced proposal to amend aspects of IAS 37 and IAS 19 (the “Exposure Draft”).

The comments expressed in this letter represent the views of the Committee only and have not been approved by the American Bar Association’s House of Delegates or Board of Governors and therefore do not represent the official position of the Association. In addition, this letter does not represent the official position of the ABA Section of Business Law, nor does it necessarily reflect the views of all members of the Committee.

I. Introduction

The IASB has proposed, in the context of amendments to IAS 37 and IAS 19, a new way of recording contingent liabilities that differs dramatically from the existing IAS, as well as from SFAS No. 5, which governs accounting for contingent liabilities under US Generally Accepted Accounting Principles (“US GAAP”). The proposal fails to take into
account the United States legal system under which, unfortunately, frivolous lawsuits have become the norm. Furthermore, under the proposed approach, the liability would have to be established at fair value, and would have to be marked-to-market at each balance sheet date, a process not only complicated and highly judgmental, but extremely time-consuming. Moreover, the approach may enable the creation of "cookie-jar" reserves because of the high potential range of values given the number of assumptions that would have to be input. In addition, the approach undermines convergence efforts, since it is inconsistent with efforts to provide the capital markets with one set of high quality global accounting standards.

II. Contingent Liabilities

The Exposure Draft proposes to substantially revise the current treatment of contingent liabilities arising from litigation. In the view of the IASB, when an entity is involved in litigation, it has a legal, unconditional obligation to "stand ready" to perform as directed by the court. The unconditional obligation to "stand ready" as the court directs qualifies as a present liability and must be recognized in its financial statements.

The Committee believes that the notion that a liability always exists in connection with a legal proceeding because the defendant "stands ready" to perform as directed by the court is inappropriate. It does not give consideration to the fact that lawsuits are a part of doing business in the United States. Tort laws in the United States permit the filing of frivolous lawsuits, and cases are often dismissed before going to trial. To suggest that a liability be recorded in every case ignores the frivolous nature of many these lawsuits. Furthermore, in a jury trial the recording of a settlement value on the balance sheet could be construed as an admission of culpability.

III. Measurement

Along with proposing to eliminate the term contingent liability, the IASB also proposes to amend the language of the measurement requirements of IAS 37. The IASB has concluded that liabilities should be measured by the amount that an entity would rationally pay to settle the obligation or to transfer it to a third party on the balance sheet date, which should reflect the risks and uncertainties surrounding the obligation. When such market evidence is not available, the Exposure Draft provides that the preferred method of measuring these liabilities is to use an expected cash flow estimation technique. The Exposure Draft also states that in "extremely rare" cases in which an entity cannot reliably measure a non-financial liability, the liability does not qualify for recognition.

There are several reasons why the Committee believes this approach to measurement is undesirable. Firstly, the Exposure Draft seems to require that years of legal services, which have not been incurred and are very difficult to calculate, be considered in recording a liability in a defended lawsuit. This exercise in connection with a lawsuit in
which losses are not expected to be probable is not appropriate and would result in the premature accrual of future operating costs.

Secondly, the IASB states that an entity should measure a non-financial liability at the amount that it would rationally pay to settle the obligation or to transfer it to a third party on the balance sheet date. This is true even if an entity firmly believes that it is not liable and therefore is not willing to pay any party any amount to assume the liability. This approach is misguided as it forces the entity to value a lawsuit on a liquidation basis and fails to take into account that the entity expects to pursue the litigation until it prevails.

Thirdly, the Exposure Draft calls for fair value accounting, which is the cost to settle the litigation or cause another entity to assume the risk, or an expected cash flow technique. Unfortunately, in contrast to financial instruments, there is not readily available market information for these items. Therefore, companies’ efforts to perform a monthly mark-to-market would be highly judgmental, complicated and exceedingly time-consuming. It would also provide little useful information for investors.

Finally, the Exposure Draft’s treatment of litigation is inconsistent with its treatment of legislation. With respect to legislation, the Exposure Draft provides that until it is enacted, there is significant uncertainty so no liability is recorded. A similar argument is applicable to a decision to defend a lawsuit, notwithstanding the need for a defendant to pay legal costs. Until there is a judicial determination or the lawsuit is settled, similar uncertainty exists, since there is uncertainty as to what amounts, if any, will be payable to the plaintiffs.

IV. Disclosure

The Exposure Draft proposes to require an entity to 1) present for any class of liability with estimation uncertainty certain disclosure required by the current IAS 37, and 2) disclose if a non-financial liability is not recognized because it cannot be measured reliably. In addition, the Exposure Draft proposes an exemption to these disclosure requirements by stating that in “extremely rare cases”, an entity need not disclose some or all of the information required by these provisions if it can be expected to seriously prejudice the entity’s position in a dispute with other parties on the subject matter of the obligation. In such cases, the entity need only disclose the general nature of the dispute and the reason why the information has not been disclosed. The Committee suggests that the IASB consider expanding this exemption to cover paragraph 67 of the Disclosure section of the Exposure Draft, which proposes to require an entity to present for each class of liability, the carrying amount of the liability at the period end together with a description of the obligation. This would protect litigants from disclosing potentially damaging information.

V. Convergence
Mr. Henry Rees, Project Manager
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The IASB has entered into a joint convergence project with the US Financial Accounting Standards Board to reduce the differences between the IASB’s International Financial Reporting Standards and US GAAP. The Committee believes that the proposals relating to loss contingencies in the Exposure Draft undermine the convergence project because they are inconsistent with SFAS No. 5. SFAS No. 5 establishes standards of financial accounting and reporting for loss contingencies under US GAAP. It requires accrual by a charge to income (and disclosure) for an estimated loss from a loss contingency if two conditions are met: (a) information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements, and (b) the amount of loss can be reasonably estimated. This is in direct contrast to the approach in proposed IAS 37.

VI. Conclusion

We are concerned that the proposed treatment of contingent liabilities relating to litigation in the IASB’s Exposure Draft fails to reflect the United States legal system, would provide misleading information to investors and adversely affect the defense of lawsuits, is internally inconsistent (e.g. its treatment of legislation) and is inconsistent with ongoing convergence efforts. Accordingly, we strongly recommend that you reconsider this aspect of the Exposure Draft.

The Committee appreciates the opportunity to comment on the proposal.

Sincerely,

Linda L. Griggs
Chair, Law and Accounting Committee

Drafting Committee:

Amy Goodman
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