January 11, 2006

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

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

Dear Director:

We appreciate the opportunity to respond to the FASB’s Invitation to Comment on Selected Issues Relating to Assets and Liabilities with Uncertainties (the “ITC”). We continue to support the convergence of United States and International accounting standards, the objective of which is to produce high-quality standards that provide reliable information to the users of financial statements.

While the ITC has posed a number of specific questions, our comments relate primarily to contingent liabilities and are set forth in the attached appendix, which consists of Altria’s comments on the IASB’s proposed amendments to IAS 37, “Provisions, Contingent Liabilities and Contingent Assets.”

If you have any questions regarding this letter, please do not hesitate to contact me.

Very truly yours,

Joseph A. Tiesi
Vice President and Controller

Attachment
October 13, 2005

International Accounting Standards Board
30 Cannon Street, London EC4M 6XH
United Kingdom

Dear Sir David Tweedie:

We are supportive of the convergence of International Accounting Standards and U.S. GAAP and would like to voice our views about the Exposure Draft of Proposed Amendments to IAS 37 and IAS 19 (the “Exposure Draft”) early in the process. Given the increasing momentum in convergence of FASB and IASB pronouncements, we believe that it is preferable to comment at this stage of the process.

Our comments, which are set forth in detail below can be summarized as follows:

- We believe that the Exposure Draft’s treatment of contingent liabilities for defended litigation is inconsistent with the Exposure Draft’s treatment of other contingent liabilities.
- We believe that the use of fair value accounting for contingent liabilities without a corresponding approach to deal with internally developed intangible assets of a business will result in significant distortion of companies’ balance sheets.
- And, it is our view that there is inadequate market data to prepare on-going fair value studies of contingencies on a timely basis.

We address each point in detail throughout the remainder of our response.

Inconsistencies in the Exposure Draft’s treatment of contingent liabilities for defended litigation compared with other contingent liabilities.

In the Exposure Draft the IASB provides a robust description of its thought process in discerning when an entity has incurred a liability. The Exposure Draft is very clear in making the following statements:

- “Only present obligations arising from past events existing independently of an entity’s future actions result in liabilities.” (Paragraph 17);
- “An intention to incur a future outflow of economic resources…is not sufficient to give rise to a liability.” (Paragraph 18); and
- “Because a liability always involves an obligation to another party, it follows that a decision by the management of an entity does not normally give rise to a present obligation at the balance sheet date.” (Paragraph 19).
These definitions are straight-forward and are followed with representative examples that indicate the following:

- A product warranty is a liability because it embodies a promise to the purchaser of the product. The promise is a liability; the amount, however, is contingent on the malfunction of the product.
- An extended product warranty that is not widely publicized, but has a history/pattern of being performed for certain customers at the discretion of the company is not a liability because the entity has not broadly communicated to customers that this is its practice (Example 4B).
- Obligations arising from the enactment of legislation are not liabilities until the legislation has been enacted or substantially enacted (Examples 10A and 10B).

These examples are consistent with the guidelines outlined in the document, but the Exposure Draft then makes the incongruous statement that lawsuits constitute a liability when the defendant decides to dispute the plaintiff’s allegations. The Exposure Draft’s position is that a liability exists because the defendant “stands ready” to perform as directed by the court. This seems to be inconsistent with the Exposure Draft’s position regarding proposed legislation. Surely a business “stands ready” to comply with a law once it is enacted. The Exposure Draft contends that there can be significant uncertainty about the passage of legislation, or the final form of the legislation that will be enacted. We believe that these arguments apply as well to defended litigation. The Exposure Draft seems to be internally inconsistent on this point.

The Exposure Draft goes on to say that a defendant in a lawsuit has a stand-ready obligation, which must be recognized as a liability in its financial statements. This approach does not give consideration to the fact that lawsuits are a part of doing business, especially in the United States. These issues are already included in general business risk and no additional accruals are necessary. The economic reality is that the cost borne by most companies to stand ready to perform against an unfavorable judgment or against a variety of business risks, is already captured by the cost to retain credit facilities. What is really required for a business entity to be ready to perform against an adverse judgment is the liquidity provided by these credit lines. Another item that the Exposure Draft says should be considered in establishing the stand-ready obligation is the cost to defend a case. The implication is that years of legal services, which have not been incurred and are nearly impossible to calculate in advance of time billed by attorneys, are suddenly to be considered in recording a liability in a defended lawsuit. This is clearly at variance with recent pronouncements that have tempered the ability to record restructuring costs before they are incurred. This premature accrual of future operating costs seems to be at variance with prevailing GAAP.

In addition to apparent inconsistencies with existing GAAP, the proposed treatment does not address the specific economics of defended litigation. As previously mentioned, maintenance of credit lines constitutes a company’s true economic cost to stand ready to perform before a court.
The Exposure Draft, however, calls for fair value accounting defined as the cost to settle the litigation or cause another entity to assume the risk of the litigation. These are measures that do not represent the value of the litigation to the defendant for the simple reason that both settlement and/or transferring the risk involve heavy market premiums that would not otherwise be incurred by the defendant. For instance, the cost to settle litigation bears with it a premium, which is the consideration paid to the plaintiffs to forego their rights to pursue the case further. If a company believes strongly in its defenses, being forced to record the settlement value would be overstating the obligation. Similarly, there is an implied premium in any insurance quote to underwrite the potential impact of the defended litigation.

Aside from disparities with existing GAAP and economic underpinnings of defended litigation, the proposed treatment of defended litigation could have potentially serious societal consequences, particularly for corporations doing business in the United States. The United States is a particularly litigious society. Tort laws allow the filing of all sorts of frivolous lawsuits. The Exposure Draft's concept that a liability has been incurred at the moment a company decides to defend itself is not consistent with a company's views if it believes that it has meritorious defenses and will win the case. In fact, recording the settlement value at the time of the decision to defend oneself could prejudice the case against the defendant. Often, cases are dismissed before going to trial. However, once a defendant has recorded a settlement liability for a case, the chances of a pre-trial dismissal of the case could be diminished. Similarly, at a jury trial, the recording of a settlement value on the balance sheet of the defendant is likely to be construed as an admission of culpability. We submit to you that, even with valid defenses, the amount recorded on the balance sheet would become the starting amount of damages to be awarded to the plaintiffs. Another societal impact that highlights the inconsistencies in this model (i.e., the premature recording of a liability) is that it opens the door to competitors using this accounting to harm each other. For instance, if one competitor's advertising, pricing or promotion has started to affect the sales volume and income of another competitor, the first competitor could file a frivolous lawsuit against the second. Even if the suit is frivolous, under the model proposed by the Exposure Draft, the second company would have to record a liability for the case if it chose to defend itself, causing the second company's earnings to be lower in the period when the case was filed.

Clearly, all of this could be avoided if the Exposure Draft were amended to equate its position regarding litigation to its position regarding enacted legislation (e.g. a court's judgment, with all appeals exhausted, would be treated like enacted legislation). In both instances, the obligation to perform is at the point at which the company can be compelled by a governmental agency to perform in some manner. This approach would recognize that the cost to stand ready to perform in the event of an adverse judicial or legislative action is included in the income statement as the cost to maintain credit lines that allow the liquidity to perform against the judgment or the enacted legislation.
The balance sheet significance of using fair value accounting for contingent liabilities without a corresponding approach to deal with internally developed intangibles of the business.

The IASB references the FASB’s recent exposure draft on business combinations as a basis for some of its findings. We believe that there is a distinct difference between the FASB’s current exposure draft and the conclusions drawn by the IASB. Although we disagree with the FASB’s new exposure draft due to the inability to realistically measure the fair value of the contingencies on an on-going basis, we see the logic in their conclusion to initially record the contingency at acquisition.

Simply stated, in an acquisition, fair value accounting is required for both assets and liabilities of the acquired entity, with the understanding that the acquirer is recording the fair value of the entity purchased. However, the IASB proposal tries to move “intangible liabilities” to a fair market basis without providing for the fair market recording of intangible assets. Put another way, the FASB statement is specific to acquisitions and attempts to promote a balanced approach wherein both assets and liabilities are presented at fair value. In contrast, the IASB’s Exposure Draft results in a striking imbalance since there is no mechanism for a company to record the value of its internally developed intangible assets. The result is stockholders’ equity that is permanently understated. This could have serious negative connotations to some companies’ debt covenants. Looking back at our previous concerns regarding defended litigation, a company’s real cost to stand ready to perform in a defended litigation is the cost of its lines of credit, which could be put in jeopardy by the effect of mixing fair value and historical cost accounting as prescribed by the Exposure Draft.

The unavailability of adequate data to fair value contingencies on a timely basis.

This is the juncture at which we disagree both with the Exposure Draft and with the FASB’s recent exposure draft on business combinations. Unlike SFAS 133 and other fair value-based accounting literature, these exposure drafts speak entirely to items that do not have the readily available market information of financial instruments. In the FASB’s proposal, there is an acquisition price for an entity, which defines its total market value, some of which should be allocated to the contingencies at acquisition. We understand the FASB’s position since it is based on an enterprise value that has traded in the market. It also involves detailed studies in the year following an acquisition to allocate that enterprise value appropriately. However, the monthly marking-to-market of contingencies that have no quoted market values (or their equivalents) would be very judgmental, complicated and exceedingly time-consuming in an era when the SEC is shortening its deadlines for financial filings. In addition, the fair valuing techniques fall beyond the scope of customary valuations in that they require the expertise of professionals other than valuation experts, such as lawyers and environmental engineers. We find this to be a very cumbersome and onerous requirement; and, given the speed to accomplish it and the need for excessive judgment in the absence of market information, we believe that the information will not be useful.
To that end, our comments to the FASB will mirror our comments to the IASB. Regarding purchase accounting, it makes sense to recognize the fair value of contingencies in an acquisition balance sheet, but continuous marking-to-market would be cumbersome and out of balance with acquired assets, which are not marked-to-market following their initial recording at fair value.

To summarize, we believe that the Exposure Draft’s model for defended litigation is inconsistent with the other positions taken in the Exposure Draft, is inconsistent with prevailing GAAP and has negative societal consequences arising from the premature recording of liabilities. Further, we believe that fair value accounting for liabilities without corresponding fair value accounting for assets is distortive to financial statements, and we do not believe that it is practical to mark-to-market liabilities in the absence of readily available market information. We believe that resultant estimates will be subject to too much management judgment to represent the fair values that they purport to be.

Finally, we thank the International Accounting Standards Board for the opportunity to comment on the Exposure Draft.

Very truly yours,

Joseph A. Tiesi
Vice President and Controller

cc: Mr. Robert H. Herz
Chairman, Financial Accounting Standards Board