



LETTER OF COMMENT NO. 107

August 8, 2008

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

File Reference No. 1600-100

Re: Proposed Statement – Disclosure of Certain Loss Contingencies – an amendment of FASB Statement No. 5 and 141(r)

Dear Mr. Golden:

Catholic Healthcare West (CHW) appreciates this opportunity to comment on the Financial Accounting Standards Board's (FASB's) exposure draft of the proposed amendment to Statement of Financial Accounting Standards (FAS) No. 5, Accounting for Contingencies and FAS 141(r), Business Combinations, which would require expanded disclosures for certain loss contingencies.

Catholic Healthcare West (CHW), headquartered in San Francisco, California, is a system of 41 hospitals and medical centers in California, Arizona and Nevada, providing a variety of healthcare, education, and other benefits to the communities in which it operates. Founded in 1986, CHW is the eighth largest hospital system in the nation and the largest not-for-profit hospital provider in California. We are committed to delivering compassionate, high-quality, affordable health care services in a compassionate environment that is attuned to every patient's physical, mental and spiritual needs. The CHW network of more than 9,700 physicians and approximately 53,000 employees provides quality health care services during more than four million patient visits annually.

As one of CHW's Core Values is Stewardship, it is integrated within CHW's Mission to consistently comply with all financial accounting and reporting requirements as well as provide quality and appropriate information to the users of the CHW financial statements and footnote disclosures. CHW has long been a leader in non-profit healthcare in promoting transparency in reporting.

Catholic Healthcare West Page 2
File 1600-100, proposed amendment to FAS 5, Accounting for Contingencies and FAS 141(r), Business Combinations
August 8, 2008

While we support the FASB's objective to provide investors and users of financial information with more transparent disclosures about loss contingencies, we do not support the issuance of the proposed Statement and have significant concerns with certain aspects of the proposed Statement.

In the exposure draft, the FASB sought comments on all matters presented in the proposed Statement, including a number of specific issues that need to be considered in the FASB's deliberations on the accounting and reporting for certain loss contingencies by amending FAS 5 and FAS 141(r). Our comments herein will center on these issues.

## **General Comments**

CHW agrees with the FASB that generally, the proposed amendment to FAS 5 and FAS 141(r) has the potential to improve the overall quality of disclosures by providing more useful and timely information with respect to loss contingencies; however, we have concerns that there is a danger of information being too speculative with respect to disclosure for certain classifications of loss contingencies. We also believe the speculative nature of certain information would obscure rather than illuminate CHW's obligations, and in some cases, the required disclosure will bring financial harm to CHW and other healthcare providers. It is further noted that the inclusion of the information required by the proposed disclosures creates significant risk of waiver of the attorney-client privilege that would ultimately be consequential to the reporting entity.

CHW understands that providing the FASB with real world examples is of great use to the Board, in order to assist in understanding the industry or entity specific concerns as it relates to comments submitted with respect to proposed Statements. Although CHW appreciates the opportunity to share other real-world examples of business cases where the requirements of the proposed disclosures would cause significant concern of unnecessary harm to our organization and/or misleading information to the users of financial statements, we would not be able to do so in a writing as even this type of writing would provide prejudicial information and could significantly jeopardize the attorney-client privilege.

Below are CHW's responses to the FASB's specific questions:

1. Will the proposed Statement meet the project's objective of providing enhanced disclosures about loss contingencies so that the benefits of those disclosures justify the incremental costs? Why or why not? What costs do you expect to incur if the Board were to issue this proposed Statement in its current form as a final Statement? How could the Board further reduce the costs of applying these requirements without significantly reducing the benefits?

CHW believes that disclosure in aggregate of amounts in the tabular reconciliation of recognized loss contingencies provides additional information which is helpful to a user of financial statements; however, the additional detailed disclosure of amounts of claims and maximum potential payments is problematic and could be misleading, as further addressed in the Q&A below.

The proposed disclosure would entail additional work on the part of management in compiling information, and also additional cost of auditors and outside law firms, and as further addressed in the Q&A below, would not yield better information for users of financial statements.

2. Do you agree with the Board's decision to include within the scope of this proposed Statement obligations that may result from withdrawal from a multiemployer plan for a portion of its unfunded benefit obligations, which are currently subject to the provisions of Statement 5? Why or why not?

Disclosure of obligations that may result from withdrawal from a multiemployer plan should only be required if it is an entity's intent to actually withdraw from such a plan. Disclosures of the consequences of activities that are not being contemplated are a distraction to the user of financial statements. Such quantification may also require additional actuarial fees.

CHW suggests that this issue be addressed in conjunction with the disclosure requirements for pension and other postretirement benefit plans, so that it is addressed in the appropriate context.

3. Should an entity be required to provide disclosures about loss contingencies, regardless of the likelihood of loss, if the resolution of the contingencies is expected to occur within one year of the date of the financial statements and the loss contingencies could have a severe impact upon the operations of the entity? Why or why not?

While CHW understands that some types of qualitative disclosure about certain loss contingencies may be warranted and supports the concept of disclosure, we believe that in most instances this will be prejudicial as further discussed below in the Q&A. CHW does not support this proposed requirement.

4. Paragraph 10 of Statement 5 requires entities to "give an estimate of the possible loss or range of loss or state that such an estimate cannot be made." One of financial statement users' most significant concerns about disclosures under Statement 5's requirements is that the disclosures rarely include quantitative information. Rather, entities often state that the possible loss cannot be estimated. The Board decided to require entities to disclose the amount of the claim or assessment against the entity, or, if there is no claim

Catholic Healthcare West Page 4
File 1600-100, proposed amendment to FAS 5, Accounting for Contingencies and FAS 141(r), Business Combinations
August 8, 2008

or assessment amount, the entity's best estimate of the maximum possible exposure to loss. Additionally, entities would be permitted, but not required, to disclose the possible loss or range of loss if they believe the amount of the claim or assessment is not representative of the entity's actual exposure.

a. Do you believe that this change would result in an improvement in the reporting of quantitative information about loss contingencies? Why or why not?

While CHW appreciates the need for more quantitative information with respect to loss contingencies, it is important that such disclosures contribute to a meaningful representation of the entity's exposure, and the proposed amendment does not accomplish this.

In many cases, as acknowledged by the FASB, claims are made for very high amounts as a negotiating strategy, and are not indicative of any real exposure to the entity. Indeed, claims are rarely settled for the initial claim amount. Further, particularly when claims are aggregated, such as in the case of a portfolio of self-insured malpractice claims, the aggregation of maximum exposure for each claim yields a total that vastly distorts the picture of what could ever occur (i.e., the probability is beyond remote).

A distinction should also be made with respect to governmental challenges, such as Department of Justice or Office of the Inspector General related claims against healthcare providers. As healthcare providers are subject to voluminous and complex laws and regulations of federal, state, and local governments, they can be subjected to future government review and regulatory actions unknown or unasserted. Government inquiries and investigations often begin with information requests, which do not provide a basis for which an entity can truly estimate the exposure of claims. The aggregation of maximum exposure to such claims would also yield a total that does not reflect what could ever occur.

Disclosure of management's estimate of maximum exposure has similar inherent limitations. Such disclosure could cause the user of financial statements unnecessary alarm and does not provide any value-added indication to the reality of what outcome would typically occur. Alternatively, users may learn that such disclosures are meaningless and should be ignored.

Potentially, the most serious concern with such disclosure, however, is unwarranted damage to an entity. Disclosure of maximum amounts would encourage plaintiffs to hold out for more than the claim might reasonably be worth, and have the unintended consequence of discouraging early settlements. In addition, disclosure of maximum amounts will serve to encourage additional claims against entities (it indeed may spawn a whole industry of consultants who read financial statements to recruit clients, or encourage a multitude of false claims against healthcare providers with the intent to simply damage them as a result of the required disclosure) and will hamper an entity's ability to resolve issues at lower amounts. The financial statement consequences of a suit with huge potential losses, even with a low likelihood of prevailing, would inflict immediate injury on the organization. As noted above, the proposed disclosure requirements would create the possibility of a sophisticated plaintiff that may be able to exploit that problem by threatening a suit and then withdrawing it in exchange for an unjustified and extortionate settlement. Past experience shows that settlements have rarely been made for the initial claim amount. The current proposal does not offer sufficient protection against such unjustified lawsuits and will cause adverse financial consequences.

b. Do you believe that disclosing the possible loss or range of loss should be required, rather than optional, if an entity believes the amount of the claim or assessment or its best estimate of the maximum possible exposure to loss is not representative of the entity's actual exposure? Why or why not?

Based on the reasons presented in our response to question 4a, we do not believe required disclosure of a possible range of loss is appropriate.

c. If you disagree with the proposed requirements, what quantitative disclosures do you believe would best fulfill users' needs for quantitative information and at the same time not reveal significant information that may be prejudicial to an entity's position in a dispute?

As a compromise between the needs of the user and the interests of the reporting entity, CHW suggests adding the tabular reconciliation of recognized loss contingencies in aggregate, but not changing the existing disclosure requirements.

5. If a loss contingency does not have a specific claim amount, will an entity be able to provide a reliable estimate of the maximum exposure to loss (as required by paragraph 7(a)) that is meaningful to users? Why or why not?

Such estimates are often not meaningful to users, as they paint a worst case. The attempt of such estimates has limited usefulness, could be misleading, can cause unnecessary alarm and can be prejudicial.

6. Financial statement users suggested that the Board require disclosure of settlement offers made between counterparties in a dispute. The Board decided not to require that disclosure because often those offers expire quickly and may not reflect the status of negotiations only a short time later. Should disclosure of the amount of settlement offers made by either party be required? Why or why not?

CHW agrees with the FASB that settlement offers should not be disclosed, because amounts are often a poor and misleading indicator of exposure. Such settlements are often simply offered as a negotiating tool with no real expectation of acceptance by the other party.

7. Will the tabular reconciliation of recognized loss contingencies, provided on an aggregated basis, provide useful information about loss contingencies for assessing future cash flows and understanding changes in the amounts recognized in the financial statements? Why or why not?

Yes, the tabular reconciliation will promote transparency by allowing users to understand activity in the reporting entity's financial statements. CHW is concerned; however, that this may result in financial statements with excessive amounts of roll-forward documentation. We recommend, again, that the scope be limited to material items.

8. This proposed Statement includes a limited exemption from disclosing prejudicial information. Do you agree that such an exemption should be provided? Why or why not?

CHW strongly agrees that the exemption should be provided and the exemption should be extended further so that an entity need not disclose the amount of the claim or management's estimate of the maximum exposure. It would be unfortunate to have disclosure rules that caused financial harm to entities.

9. If you agree with providing a prejudicial exemption, do you agree with the two-step approach in paragraph 11? Why or why not? If not, what approach would you recommend and why?

The first step (aggregation at a higher level) as outlined is acceptable. The second step does not go far enough. An entity should be exempted from disclosing the amount of claims or assessments in circumstances where it is prejudicial.

10. The International Accounting Standards Board (IASB) continues to deliberate changes to IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, but has not yet reconsidered the disclosure requirements. The existing disclosure requirements of IAS 37 include a prejudicial

Catholic Healthcare West Page 7
File 1600-100, proposed amendment to FAS 5, Accounting for Contingencies and FAS 141(r), Business Combinations
August 8, 2008

exemption with language indicating that the circumstances under which that exemption may be exercised are expected to be extremely rare. This proposed Statement includes language indicating that the circumstances under which the prejudicial exemption may be exercised are expected to be rare (instead of extremely rare). Do you agree with the Board's decision and, if so, why? If not, what do you recommend as an alternative and why?

Because of the volume and diversity of lawsuits against healthcare providers in the United States, CHW agrees with the FASB that under the proposed Statement, the IAS 37 requirement that these exemptions are *extremely rare* is inappropriate. The current proposal is an improvement, but also is inappropriate, in that CHW believes that the prejudicial exemption will need to be invoked frequently.

11. Do you agree with the description of prejudicial information as information whose "disclosure... could affect, to the entity's detriment, the outcome of the contingency itself"? If not, how would you describe or define prejudicial information and why?

The description is adequate; however, we believe that disclosure is prejudicial in most instances. As a result, the use of the prejudicial information exemption will be the rule, not the exception.

12. Do you believe it is operational for entities to disclose all of the proposed requirements for interim and annual reporting periods? Should the tabular reconciliation be required only annually? Why or why not?

If the proposed amendment to FAS 5 and FAS 141(r) is required, it is reasonable that the disclosure of required information be made for annual reporting periods, but should not be required on an interim basis.

13. Do you believe other information about loss contingencies should be disclosed that would not be required by this proposed Statement? If so, what other information would you require?

The proposal could be strengthened by addressing how it pertains to tax issues and asset retirement obligations. Also, CHW suggests that disclosure associated with self-insured malpractice programs, which are unique to the healthcare industry and which are different from other contingent liabilities in that they are often numerous and are typically estimated actuarially, be subject to the requirements outlined in the AICPA Audit and Accounting Guide for Health Care Organizations or FAS 60, instead of the proposal here.

14. Do you believe it is operational for entities to implement the proposed Statement in fiscal years ending after December 15, 2008? Why or why not?

There would be a burden on entities to implement the proposed amendment to FAS 5 and FAS 141(r) as of the effective date noted. There are other concerns that are raised, in addition to and above those raised in the body of this comment letter, with respect to the implementation of the proposed amendment, such as significant process required to establish and agree on the appropriate level of work to be performed by auditors and attorneys (whom both must issue opinions in conjunction with the issuance of audited financial statements) as well as costs that will be incurred by the entity to establish systems to collect the required information. The proposed amendment may also prove challenging and significantly more costly for entities to determine what corroborative evidence could even be provided to auditors in order to support the internal controls over financial reporting for these disclosure requirements as well as validity of any possible estimates made by management.

Thank you for the opportunity to comment. We are always ready to provide additional comments, or meet with you or members of your board, to discuss this matter further. If we can provide additional material or perspective on this issue, please contact Mary Connick, Vice President-Finance and Corporate Controller, at (415) 438-5592 or by email at mconnick@chw.edu.

Sincerely,

Michael D. Blaszyk

Executive Vice President and Chief Financial Officer

Catholic Healthcare West

Mary Connick

Vice President-Finance and Corporate Controller

Catholic Healthcare West