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LETTER OF COMMENT NO. 70

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

File Reference: 1600-100
Re: Proposed Statement — *Disclosure of Certain Loss Contingencies* — an amendment of FASB Statements No. 5 and 141(R)

Dear Mr. Golden:

Deloitte & Touche LLP is pleased to comment on the FASB's proposed Statement, *Disclosure of Certain Loss Contingencies* — an amendment of FASB Statements No. 5 and 141(R).

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 issuance of the proposed Statement because, among other things, we are concerned about an auditor's ability to audit some of the proposed disclosures. In the body of this comment letter, we discuss pervasive concerns related to some of the proposed disclosures that we believe need to be addressed. In the Appendix, we articulate our responses to each of the questions posed by the FASB in its request for comments on the proposed Statement.

Preparers' Ability to Make Reliable Estimates

Based on our discussions with entities and our experience in the past, we are concerned about preparers' ability to make reliable estimates of their exposure to loss in many circumstances. By nature, many types of contingencies are affected by a number of factors that are difficult to predict and estimate. In many cases, there are not established methods for estimating an entity's exposure to loss and any estimate is likely to be highly subjective. Therefore, we do not support the proposed requirement for entities to disclose an estimate of their maximum exposure to loss.

Auditing Concerns

We are concerned about an auditor's ability to obtain a reasonable level of assurance in auditing some of the proposed disclosures, such as (1) estimates of the entity's maximum

exposure to loss, (2) underlying assumptions used in arriving at that estimate, (3) the most likely outcome, and (4) whether a disclosure meets the prejudicial exemption. The information that management might use to develop estimates and support amounts included in the related disclosures could come from sources to which the auditor does not have access. For example, management may have conversations with attorneys that are covered by attorney-client privilege and in which auditors would not be able to participate.

Lawyers' responses to letters of audit inquiry are typically the primary evidence auditors use to corroborate managements' assertions associated with these types of contingencies. These communications fall within the scope of the AICPA's and the PCAOB's auditing standards in *Professional Standards,* AU Section 337, "Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments," and the American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (December 1975) ("ABA Statement of Policy") (see AICPA and PCAOB *Professional Standards*, AU Section 337C). As noted in the ABA Statement of Policy, a "lawyer should not be asked, nor need the lawyer undertake, to furnish information to the auditor concerning loss contingencies except as contemplated by [the ABA Statement of Policy]." We believe that the current form of lawyers' responses would not provide the auditor with sufficient, appropriate audit evidence to corroborate management's assertions about the proposed disclosures because the ABA's guidance in the ABA Statement of Policy is based on the existing accounting and disclosure requirements in Statement 5 and not on the proposed expanded disclosures.

Therefore, an appropriately revised ABA Statement of Policy would need to be in place before the FASB proceeds with proposed disclosures that rely on legal judgments. We believe that revisions to the proposed Statement should be accomplished through a dialogue between the ABA and the PCAOB, with input from the auditing profession, the SEC, and the preparer community. Renegotiation of the ABA Statement of Policy could take a significant amount of time and may prove difficult when a lawyer's response could be viewed as a breach of attorney-client privilege, an admission, or otherwise prejudicial to a client. Accordingly, the effective date of the proposed Statement is too aggressive.

If the enhanced disclosures would be useful to others (see our comments below), the FASB may wish to consider whether the disclosures would be more appropriately furnished outside the audited financial statements and footnotes. For example, the SEC could amend its MD&A requirements to enhance current disclosures about loss contingencies.

Usefulness to Users of Financial Statements

While we agree that some type of qualitative disclosure is warranted about loss contingencies, including certain remote loss contingencies, we believe that the proposed quantitative disclosures would have limited usefulness, could be misleading, and may unnecessarily alarm some users of financial statements. In many circumstances, it will be difficult for preparers to develop reliable estimates of maximum exposure to loss and determine whether a contingency is expected to be resolved within one year, even if they were to engage outside specialists.

Although disclosure of the claim amount, if stated, may be verified objectively and may not be prejudicial, we urge the FASB to consider further whether this information is meaningful to financial statement users. Specifically, the claim amount (1) often bears little relation to the ultimate outcome, (2) may increase or decrease repeatedly over time, and (3) is a number for which a plaintiff has minimal accountability. Such amounts are often inflated, and the proposed Statement might encourage inflation of them for sensational or tactical purposes. In addition, the claim amount is often likely to have no or very limited usefulness in the assessment of likelihood, timing, and amount of future cash flows associated with loss contingencies. This is particularly true for cases that have only a remote likelihood of succeeding.

We do not agree that, when there is no claim amount, an entity should be required to disclose an estimate of the maximum exposure to loss and its assumptions in arriving at that estimate. In many cases, any estimate of the maximum exposure to loss is likely to be highly subjective and difficult to verify objectively. The ABA Statement of Policy states that "the amount or range of potential loss will normally be as inherently impossible to ascertain, with any degree of certainty, as the outcome of the litigation. Therefore, it is appropriate for the lawyer to provide an estimate of the amount or range of potential loss . . . only if he believes that the probability of inaccuracy of the estimate of the amount or range of potential loss is slight." Moreover, we question why a defendant should be required to estimate the maximum exposure to loss and describe its assumptions in estimating that amount if the plaintiff has not quantified the amount of its claim. In addition, the maximum exposure to loss may be boundless because of the unpredictability of the legal process.

Legal Concerns

The proposed Statement raises legal issues that preparers of financial statements may not easily overcome. The FASB should consult with legal specialists to determine whether the required disclosures and auditing thereof could harm an entity's defense, specifically the requirements to provide (1) an estimate of the maximum exposure to loss and assumptions in arriving at that estimate and (2) an evaluation of the most likely outcome. For example, the ABA Statement of Policy states, "Lawyers should bear in mind, in evaluating claims, that an adverse party may assert that any evaluation of potential liability is an admission."

The proposed Statement includes an exemption in "rare instances" from providing information that may be deemed prejudicial. We agree that an exemption from disclosing prejudicial information should be provided; however, we anticipate that it would be used more often than in "rare instances," and that auditing these types of assertions may prove challenging and potentially harmful to an entity's defense because of potential breach of attorney-client privilege.

* * * * * *

We appreciate the opportunity to comment on the proposed Statement. If you have any questions concerning our comments, please contact Magnus Orrell at (203) 761-3402.

Yours truly,

Deloitte & Touche LLP

cc: Robert Uhl

APPENDIX A
Deloitte & Touche LLP
Responses to Proposed Statement's Questions

Question 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?

We support the FASB's objective of providing enhanced disclosures about loss contingencies as an interim measure until the FASB addresses the recognition and measurement issues in a longer-term project. However, we are not convinced that the proposed Statement strikes the right balance between benefits and costs. We urge the FASB to consult with preparers and legal specialists to more thoroughly evaluate the direct and indirect costs of providing the proposed disclosures.

Some companies would incur substantial direct costs to comply with the requirements of the proposed Statement. For example, entities with large numbers of lawsuits would need to establish and maintain new information systems to collect and report all of the data to be disclosed. And because the progress of lawsuits changes frequently, this information would need to be updated and maintained constantly, which would be expensive and time-consuming for some companies (especially for interim periods, as discussed in the proposed Statement). Furthermore, entities might incur additional fees and costs associated with the work of outside counsel and auditors in preparing and corroborating the information. We remain unconvinced that many of the proposed disclosures, such as (1) claim amounts, (2) an entity's estimate of its maximum exposure to loss, or (3) certain remote loss contingencies, would provide useful information to investors and warrant the additional costs for preparers.

In addition, the proposed disclosures could result in substantial indirect costs to a company and its investors if they were to negatively affect an entity's ability to defend itself in litigation and settlement negotiations. While the proposed Statement contains an exemption from disclosing prejudicial information, that exemption is subject to strict conditions and does not extend to disclosure about, for example, the entity's estimate of the maximum exposure to loss if there is no claim amount. The FASB should consult with legal specialists to determine whether preparing, providing, or auditing the proposed disclosures could cause harm to an entity's defense. For example, we would be concerned if audit testing of the use of the prejudicial exemption or the assumptions underlying other disclosures could result in a loss of client-attorney privilege.

Question 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?

We agree that these obligations should be included in the proposed Statement. We suggest that the FASB also consider this issue in the context of pension plan disclosures.

Question 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 we understand that some type of qualitative disclosure may be warranted about certain loss contingencies that could have a severe impact in the near term, we are concerned that the proposed quantitative disclosures have limited usefulness, could be misleading, and may unnecessarily alarm some financial statement users. In addition, we are concerned that preparers will find it difficult to determine whether a contingency is expected to be resolved within one year

We do not support the proposed requirement for an entity to disclose a claim amount for loss contingencies when the loss has only a remote likelihood of occurring. In many cases, the claim amount bears little, if any, relation to the ultimate outcome and is likely to be of very limited usefulness in assessing the likelihood, timing, and amount of future cash flows associated with loss contingencies. This is particularly true for cases that have only a remote likelihood of succeeding.

We do not support the proposed requirement that, when there is no claim amount, an entity must disclose an estimate of the maximum exposure to loss and its assumptions in arriving at that estimate. In many circumstances, it will be difficult for preparers to develop reliable estimates of their maximum exposure to loss, even if they engage outside specialists. Estimates of the maximum exposure to loss can be highly subjective and difficult to verify objectively. Moreover, we question why a defendant should be required to estimate the maximum exposure to loss and describe its assumptions in estimating that amount if the plaintiff has not quantified the amount of its claim.

In addition, we urge the FASB to consult with legal specialists to determine whether the disclosure could harm an entity's defense. The ABA Statement of Policy states, "Lawyers should bear in mind, in evaluating claims, that an adverse party may assert that any evaluation of potential liability is an admission."

To avoid disclosure of loss contingencies when there is no practical likelihood of the loss occurring, but when its occurrence could have a severe impact, the FASB should consider including additional criteria, such as whether:

- Information about the loss contingency is provided internally to key management personnel such as the entity's board of directors or chief executive officer.

- The contingency "is likely to have" a severe impact if it were to occur (rather than "could have" a severe impact if it were to occur).

Question 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 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?*

We believe that even though disclosure of the claim amount may be verified objectively and not be prejudicial, the FASB should consider further whether this information is helpful to financial statement users. Specifically, the claim amount (1) often bears little relation to the ultimate outcome, (2) may increase or decrease repeatedly over time, and (3) is a number for which a plaintiff has minimal accountability. Such amounts are often inflated for sensational or tactical purposes.

Other than when the amount can be reasonably estimated, we are not convinced that disclosure of an estimate of the maximum exposure to loss will be helpful to users of financial statements. Estimating the maximum exposure to loss will often be subjective and depend on non-economic factors that are difficult to quantify. In addition, the maximum exposure to loss may be boundless because of the unpredictability of the legal process. Different methods for estimating loss contingencies also may hinder the comparability of financial statement disclosures. The FASB should consult legal specialists to determine whether the methods used are sufficiently consistent to meet the expectations of users regarding the comparability of financial statement presentation by issuers.

Moreover, obtaining audit evidence to support the estimate will often be difficult, and disclosure of this amount and the assumptions used in arriving at the estimate may be frequently viewed by entities as prejudicial. We question why a defendant should be required to disclose its estimate of the maximum exposure to loss if the plaintiff has been unwilling or unable to quantify its claim.

> *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?

We agree with the FASB's proposal that disclosing the possible loss or range of loss should be optional. Although there are not often established methods for determining the best estimate of loss or range of loss and such an estimate is likely to be highly subjective, this disclosure would be more useful than the other proposed quantitative disclosures.

However, obtaining audit evidence to support the amounts will be challenging. The ABA Statement of Policy states that "the amount or range of potential loss will normally be as inherently impossible to ascertain, with any degree of certainty, as the outcome of the litigation. Therefore, it is appropriate for the lawyer to provide an estimate of the amount or range of potential loss . . . only if he believes that the probability of inaccuracy of the estimate of the amount or range of potential loss is slight."

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?

We recommend that the FASB limit any quantitative disclosure requirements to amounts that can be reasonably estimated.

To address the issues regarding an auditor's ability to obtain evidence in auditing some of the proposed disclosures, the FASB may also wish to consider whether enhanced quantitative disclosures about loss contingencies could be more appropriately furnished outside the audited financial statements and footnotes. For example, the SEC could amend its MD&A requirements to enhance current disclosures about loss contingencies.

Question 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?

We believe that an entity often will not be able to provide a reliable estimate of the maximum exposure to loss that is meaningful to users. See our response to Question 4 above.

Question 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?

We agree that for the reasons provided in the question, disclosure of settlement offers should not be required.

Question 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?

We agree that, except when it could be prejudicial, the proposed disclosure of a reconciliation of aggregate changes in loss contingencies that have already been recognized in the financial statements is useful. This reconciliation may provide information to users of financial statements about management's use of estimates in determining amounts accrued for loss contingencies. However, the proposed requirement to provide a qualitative description of the significant activity in the reconciliation may often prove to be prejudicial.

Question 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?

We agree that an exemption from disclosing prejudicial information should be provided. However, we expect that auditing these types of assertions may prove difficult because of attorney-client privilege (as discussed in the body of this comment letter). In addition, although the proposed Statement suggests that use of this exemption would be rare, we believe that companies and their attorneys will frequently view certain types of disclosures as prejudicial, such as the entity's best estimate of the maximum exposure to loss, the most likely outcome, and the significant assumptions used in estimating quantitative information.

The proposed Statement is unclear about what constitutes "prejudicial" and how a company would go about making such an assessment. The FASB should provide more guidance about this and consult with preparers, attorneys, and users about what components make up this determination and what the appropriate disclosures should be regarding the prejudicial exemption.

Question 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?

We believe that the proposed Statement should not presume that disclosure of information required by paragraph 7, when aggregated at a higher level, or of the tabular reconciliation, would be prejudicial only in "rare" instances. For example, companies with only one major dispute may frequently need to invoke the prejudicial exemption. In addition, we do not agree with the FASB's proposal that an entity should not be permitted to use the prejudicial exemption to forego disclosing an estimate of the maximum exposure to loss (in the absence of a claim amount) or the potential impact on the outcome. We believe that if such information is prejudicial, an entity should not be required to disclose it.

We believe that in certain circumstances, aggregation under the two-step approach may be helpful. However, the FASB should provide more guidance on how to apply this approach (e.g., by adding illustrative examples of the aggregation process).

Question 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 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?

See our response to Question 8 above.

Question 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?

We believe that the FASB should consult with legal specialists to determine whether this is an appropriate description of prejudicial information.

Question 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?

We believe that the tabular reconciliation should be required only on an annual basis. If there are significant changes to the year-end estimates, public companies are already required under SEC regulations to disclose these on an interim basis.

Question 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?

We have not identified any other information about loss contingencies that we believe should be disclosed.

Question 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?

We believe that the proposed effective date is too aggressive. As noted in the body of this comment letter, we believe that an appropriately revised ABA Statement of Policy should be in place before the FASB proceeds with the proposed disclosures that rely on legal judgments. In addition, implementation of the proposed Statement may prove challenging for companies

with a large portfolio of cases. Such companies may need to incur substantial costs to establish information systems to collect the required information and obtain attorney opinions needed to prepare and audit the information.

Another concern is how the gathering, processing, and reporting of these increased disclosures would be covered under an entity's internal control over financial reporting. We expect this would take a significant amount of time and effort for some companies to implement because they would need to make changes to their existing process and controls to comply with the proposed Statement.

In addition, the effective dates of the proposed Statement and Statement 141(R) conflict. Although the proposed Statement includes an amendment to Statement 141(R), the proposed Statement would be effective before companies are required to implement Statement 141(R). This means that the proposed Statement would apply to loss contingencies in the scope of Statement 141(R) before Statement 141(R) itself becomes effective. The FASB should address this inconsistency.