2525 Dupont Drive, P.O. Box 19534, Irvine, California, USA 92623-9534 Telephone: (714) 246-4500 Website: www.allergan.com



## VIA E-MAIL

July 16, 2008

Mr. Russell G. Golden Technical Director File Reference No. 1600-100 Financial Accounting Standards Board of the Financial Accounting Foundation 401 Merritt 7 P.O. Box 5116 Norwalk, Connecticut 06856-5116



LETTER OF COMMENT NO. 5

Proposed Statement of Financial Accounting Standards - Disclosure of Certain Re: Loss Contingencies – an amendment of FASB Statements No. 5 and 141(R)

Dear Mr. Golden:

Allergan, Inc., a Delaware corporation ("Allergan" or "we"), appreciates the opportunity to respond to the Financial Accounting Standards Board ("FASB" or the "Board") regarding the Proposed Statement of Financial Accounting Standards, Disclosure of Certain Loss Contingencies, an amendment of FASB Statements No. 5 and 141(R) (the "Proposed Statement"). Allergan is a publicly traded, multi-specialty health care company listed on the New York Stock Exchange under the symbol "AGN."

Under the heading "Why Is the FASB Issuing This Proposed Statement and When Is It Effective?", the Board has indicated that the Proposed Statement is based on the premise that:

"Investors and other users of financial information have expressed concerns that disclosures about loss contingencies under the existing guidance in FASB Statement No. 5, Accounting for Contingencies, do not provide adequate information to assist users of financial statements in assessing the likelihood, timing, and amount of future cash flows associated with loss contingencies."

We respectfully disagree with the notion that the majority of investors, financial statement users and/or preparers believe that the existing FASB Statement No. 5's loss contingency guidance is inadequate. Instead, we believe that the impetus for the wholesale revision of a framework that has been in place and has been effective for over 30 years is being promoted by a small group of vocal proponents that do not speak for the broader financial community. Furthermore, we believe that those in greatest need of expanded loss contingency disclosure, including commercial and investment banks, credit rating agencies and insurers, can obtain access to additional disclosure to evaluate loss contingencies and the bases for their accounting. We therefore request that the Board provide qualitative and quantitative information detailing the concerns that led to the Proposed Statement.

Allergan, Inc. July 16, 2008 Page 2 of 3

We believe that the current FASB Statement No. 5 is an excellent example of a principles-based accounting standard and that the American Institute of Certified Public Accountants' Statement of Position ("SOP") 94-6, Disclosure of Certain Significant Risks and Uncertainties, already embodies many of the concepts in the Proposed Statement, including the "near term" and "severe impact" concepts. By their very nature, contingencies often involve complex issues and judgments that do not lend themselves to summarized discussions. Broadening the disclosure requirements and the number of issues requiring disclosure, we believe, would create more confusion than clarity – particularly with respect to the disclosure of a company's maximum exposure to a contingent liability (as discussed in response to Question No. 5 in Exhibit 1 to this letter) and with respect to quantitative disclosures of remote loss contingencies and unasserted loss contingencies. In addition, for public companies, a disclosure of risk factors is included in SEC registration statements and periodic filings, supplementing the information included in financial statements.

We would also like to acknowledge our agreement with the concerns expressed in the December 4, 2007 letter sent to Chairman Herz by a group of senior litigators from a number of large U.S. corporations and the April 17, 2008 letter that was sent to Chairman Herz by the Committee on Corporate Reporting of Financial Executives International (attached hereto as Exhibit 2 and Exhibit 3, respectively). The Proposed Statement infers an ability to assess outcomes that simply does not exist. A recent example of the unpredictability of litigation and the length of time necessary to reach ultimate disposition is the Supreme Court's June 25, 2008 decision on the 1989 Exxon Valdez oil spill, which was released almost 20 years after the incident occurred.

We are not aware of a widespread incidence of substantial adverse outcomes from undisclosed contingencies, other than in connection with recent and continuing losses incurred by certain real estate developers and financial institutions. The scope of the Proposed Statement, however, exempts these types of contingencies, so it appears that the entire population of financial statement issuers is being punished for the misdeeds of a few.

Lastly, under the heading "How Does This Proposed Statement Relate to International Convergence?", the Proposed Statement identifies accounting differences between disclosure requirements that have not yet been addressed by the International Accounting Standards Board. With the impending convergence of global accounting and reporting standards, we believe that it would be a mistake for the two standard-setting bodies not to be in agreement before any final decisions are made. Otherwise, financial statement preparers and users will be faced with continuing uncertainty and incongruity, as well as the specter of additional changes, which reflects poorly on the accounting profession.

We have included in <u>Exhibit 1</u> to this letter our comments on the specific questions that are enumerated in the Proposed Statement. In <u>Exhibit 1</u>, the italicized material sets forth the Board's question, followed by our comments.

Allergan, Inc. July 16, 2008 Page 3 of 3

Thank you for your consideration.

Respectfully,

/s/ James F. Barlow
James F. Barlow
Senior Vice President,
Corporate Controller
(Principal Accounting Officer)

/s/ Jeffrey L. Edwards
Jeffrey L. Edwards
Executive Vice President,
Finance and Business Development,
Chief Financial Officer
(Principal Financial Officer)

/s/ Douglas S. Ingram
Douglas S. Ingram, Esq.
Executive Vice President,
Chief Administrative Officer
General Counsel and Assistant Secretary

### Responses to Individual Questions in the Proposed Statement

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?

No, for the reasons set forth in the accompanying letter and in response to Question 5 below. If the Proposed Statement is issued in its current form as a final statement, we will incur significant outside legal costs to assist our inside legal staff with drafting the required disclosures on a quarterly basis. We also believe that the Proposed Statement's disclosure standards would result in disclosures that are so long and complex as to be unintelligible to most financial statement users, which is contrary to the SEC's stated disclosure goals of clarity and certainty. In addition, we believe that while disclosures mandated by the Proposed Statement will be viewed by users of the financial statements as reliable predictors of the outcome of the contingent liability discussed, those disclosures will actually be based on unreliable estimates we will be forced to make in order to comply.

We believe the level of quantitative and qualitative disclosures required under FASB Statement No. 5, as they exist today, are effective and appropriate in meeting financial statement users' needs. In addition, we believe the principles expressed in FASB Statement No. 5 are well understood and both regularly and rigorously deliberated by preparers of financial statements. Within an equitable and clearly defined framework, management must be allowed to apply its judgment to determine the timing and format of financial statement disclosures. We believe it would be detrimental to the emerging concept of principles-based, or objectives-based, accounting standards, which generally leave implementation to the judgment of preparers and auditors, if the Board issued the Proposed Statement in its current form as a final statement. Frankly, we know of no better example of a pure principles-based accounting standard than FASB Statement No. 5 as it exists today.

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 obligation, which are currently subject to the provisions of Statement 5? Why or why not?

No. Because the contingencies resulting from such actions are already encompassed by FASB Statement No. 5, they do not need to be specifically addressed by the Proposed Statement.

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?

No. Eliminating the "reasonably possible" limitation that presently exists in SOP 94-6 would create a substantial number of new contingencies. We believe that most financial statement users would be confused by this because they would read about a risk followed by a lengthy discussion of why the issuer does not feel that the contingency is likely.

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?

No. There are a number of contingencies, including accounts receivable reserves, warranty liabilities and restructuring reserves for which the existing reporting requirements require detailed disclosures. Material litigation matters are also often given a similar level of detail. That said, because of the nature of litigation and uncertainties involved in many contingencies, the amount of the claim or assessment is very often much higher than the ultimate settlement and is not based on the claimant's actual expectations. In these cases, we believe that disclosing the amount of the claim would be misleading. Similarly, a company's ability to disclose useful quantitative information about unasserted loss contingencies will often be limited.

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?

No. Requiring these disclosures would be misleading to financial statement users and would be highly detrimental to companies' ability to negotiate a settlement or pursue available defenses. Please also see our further response to Question No. 5 below.

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?

Irrespective of potential prejudice, we feel that any mandated expansion in the level of required quantitative information implies a level of precision that simply does not exist.

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?

No. In our litigation experience and as is customary, claims are typically made without the plaintiff specifying the total damage amount. This includes product liability claims, securities class action claims, whistleblower claims and intellectual property infringement claims. Moreover, in cases where a plaintiff does claim a specific damage amount in the complaint, the amount is often subject to change as discovery proceeds, additional facts are learned, and damage experts are retained and opine. It is primarily in these contexts, where damages are highly speculative, that we would be required by the Proposed Statement to estimate our maximum exposure to loss. Even where, by the nature of the claim being made, we may be able to provide a reasonable estimate of the most likely possible loss, we are not likely to be able to reasonably and reliably estimate the claim's maximum exposure. For example, if, despite our attempts to settle a matter on terms consistent with past experience, a plaintiff pursues a case to a full jury trial, we would be unable to provide an estimate of what a jury might award. Each plaintiff will have unique injuries and will elicit varying degrees of sympathy from a jury, and could also successfully make arguments not made by prior plaintiffs. All of these issues would impact the overall verdict and loss, and we are therefore unable to predict with any reliability the outcome of a trial. Furthermore, doing so would not be helpful to a financial statement user because the most likely range of outcomes would be significantly different than the total maximum exposure.

The foregoing problems with determining a particular claim's maximum exposure are compounded in cases where the facts and claims are of a more unique and individual nature. In those circumstances, while we may believe that we understand a range of possible settlements, neither we nor our outside counsel may have a true sense of the maximum exposure. Indeed, in most cases, even the plaintiff cannot provide a damage estimate until discovery is closed, all relevant facts are learned and damage experts have been consulted. Requiring us to provide a prediction regarding the maximum exposure would be substantially based on conjecture as to what may be learned during the course of the lawsuit and therefore, totally unreliable. Additionally, any such estimate would likely be wrongly perceived by financial statement users as being fact-based. Thus, the estimate would be misleading as to the true nature of the potential maximum liability.

Even if at some point during a particular litigation matter it appears that we may be able to determine our maximum exposure (e.g., if the plaintiff's damages expert opines on the damages or the plaintiff proposes a settlement offer), we still could not state with any certainty what the maximum exposure ultimately might be. As additional facts come to light during the discovery process or legal rulings are issued by the court (or by appellate courts), our assessment of our maximum exposure would necessarily change. Accordingly, to the extent that we are able to make any assessment of our maximum exposure in connection with preparing and finalizing our

For example, through our 2006 acquisition of Inamed Corporation we assumed several ongoing breast implant tort claims. Claims of this nature have been brought and resolved over several years and we believe that we are generally able to determine a reasonable estimate of the likely range of loss associated with most of the claims.

financial reports for any particular accounting period, that assessment would almost certainly be materially outdated shortly after being issued.

Because a publicly-traded company's financial statements are filed with the Securities and Exchange Commission and subject the issuer to liability under, among other laws, the Securities Act of 1933 and Securities Exchange Act of 1934, issuers will likely be compelled to provide conservative estimates of their maximum liability exposure. This is particularly true as issuers come to understand that if the required disclosures and estimates prove to be inaccurate, as some inevitably will, they become sources of additional claims and litigation.

Consequently, users of financial statements will not receive an accurate view of an issuer's total maximum exposure or be able to accurately assess the potential liability faced by a particular issuer or group of issuers in the same industry.<sup>2</sup> While the estimate of maximum exposure to loss will not be helpful to financial statement users for this and other reasons discussed in this response, it will almost always be highly detrimental to the issuer in resolving the claim. For example, the maximum exposure estimate may be used by plaintiffs as admissible evidence in the proceeding itself or as leverage during settlement discussions. Disclosure of the maximum exposure together with the required disclosure of the company's "qualitative assessment of the most likely outcome...the anticipated timing of [the claim's] resolution...and the significant assumptions made by the [company] in estimating the amounts disclosed" runs the risk, and more likely the reality, of revealing aspects of defendant's analysis of the claim that have historically and appropriately been guarded in adversary proceedings.

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?

No. We agree with the Board's conclusion as set forth in the question.

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?

In the case of litigation matters, no. Although such a reconciliation might prove informative by providing the absolute amounts of aggregated contingencies at the balance sheet dates, the requirement for a qualitative description of the significant activity in the reconciliation would potentially entail a level of complexity that we believe is beyond the ability of most financial statement users to effectively comprehend or find useful.

This issue is not fully addressed by the issuer's ability to provide the best estimate of the loss or possible range of loss. Such an estimate will (i) similarly be provided on a very conservative basis and (ii) be used to qualify the validity of the estimate of the maximum exposure to loss, which will lead to a confusing analysis in which the financial statement user is provided with what appears to be helpful quantitative data but is actually left to "read the tea leaves" provided by the disclosure.

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 with the concept of an exemption from disclosing prejudicial information, but do not agree that it should necessarily be limited to "rare instances." That decision, we believe, could be very common for a specific entity or during a particular reporting period and an attempt to limit it in that manner is not reasonable. Please also see our response to Question No. 5.

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?

No. As previously stated in our response to Question 7, we do not agree that the tabular reconciliation is useful.

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?

No. This question raises the more fundamental issue of international convergence. We do not believe that a standard should be considered before the FASB and IASB are in agreement.

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 this standard is too narrow as drafted in the Proposed Statement. We are concerned that the standard does not sufficiently protect issuers that have had loss contingencies asserted against them for some of the reasons discussed in the last paragraph of our response to Question 5 above. In addition, the standard does not address issues raised by the fact that the required disclosures are likely to be based on confidential communications between companies and their counsel which may cause the disclosure to constitute a waiver of the attorney/client privilege or work product immunity. This partial waiver of the ultimate conclusion of the conversation may also be used to assert a waiver of the underlying discussion and analysis leading to the disclosure. In addition, we believe that our independent registered public accounting firm will seek to test our estimates and disclosures as part of its audit work, which could lead it to seek detailed information from counsel that will also pose waiver risks.

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?

No. Even if we agreed with the proposed requirements for annual reporting periods, such requirements for interim periods would be inconsistent with the basic premises of interim reporting, i.e., that condensed information be presented and that only significant developments since the most recent annual reporting period be subject to interim disclosure.

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?

No.

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?

No. The Board added this issue to its technical agenda on September 6, 2007 but did not issue an exposure draft for nine months. It is unreasonable to expect that the issues can be fully discussed, deliberated and implemented during 2008 for issuers who report on a calendar year basis.

Legal
Pfiser Inc
235 East 42nd Street
New York, NY 10017
Tel 212 733 9105 Fax 212 883 5902
Email sandra.l.phillips@pfiser.com

Golden



Sandra L. Phillips Sesior Vice President & Associate General Counsel Chief Litigation Counsel

December 4, 2007



LETTER OF COMMENT NO. 2

Robert H. Herz, Chairman Financial Accounting Standards Board 401 Merritt 7 P. O. Box 5116 Norwalk, CT 06856-5116

Sir David Tweedy, Chairman International Accounting Standards Board 30 Cannon Street London EC4M 6XH United Kingdom

#### Dear Sirs:

Each of us is a senior litigator for a large U.S. corporation. Although we are not accountants, we believe that it is important to provide our perspective on the Financial Accounting Standard Board's (FASB) recent decision to add a project on accounting for contingencies to its agenda. We have followed developments related to accounting for contingencies with great interest subsequent to issuance of the 2005 Invitation to Comment, Selected Issues Related to Assets and Liabilities with Uncertainties. We also are aware of recent decisions made by the FASB with respect to the guidance on subsequent measurements in the forthcoming standard on business combinations. A critically important element within the broad spectrum of potential assets and liabilities within the scope of this project is the area of litigation, which has attributes that require special consideration in the Board's deliberations on new accounting and disclosures related to contingencies. As litigators, we are intimately familiar with the complexities that arise in the consideration of potential liabilities related to asserted and unasserted claims, the practical realities associated with recognition and measurement based on limited information, as well as the nature of the legal system, which adds to the general uncertainty of outcomes.

We understand that many FASB and (IASB) members are concerned that recognition of a liability under SFAS 5<sup>1</sup> takes place far too long after the filing of a lawsuit or the bringing of a claim, and their view that fair value should be used so that recognition of a liability in the financial statements occurs earlier. We do not believe that the fair value of contingent assets and liabilities related to litigation can be reliably measured in many cases, especially in the early stages of an asserted claim. In addition, we believe that such a requirement could lead to significant unintended consequences. For all of the criticism that has been leveled against it, we believe that the SFAS 5 model for accounting for contingencies is appropriate and well-understood by all constituents, including investors, and is capable of high quality application and audit because it requires a contingency to reach a level of being "probable and estimable" before it is recorded.

Litigation is inherently unpredictable. Proof of that unpredictability can be seen in cases, such as the infamous case against McDonald's involving damages from a spilled cup of coffee, the differing verdicts for the first Vioxx cases tried against Merck or in a variety of other contexts. Moreover, determining when during litigation the probability of loss changes and by how much is highly judgmental. The SFAS 5 standard of recognizing a liability only when it is probable and estimable embraces this judgment. It also is consistent with the recognition that the filing of a lawsuit in today's environment is not necessarily a significant event affecting the company's financial exposure. Too often, lawsuits are filed for publicity or to pressure companies, only to be dropped later: either voluntarily or as a result of being dismissed by the Court. Moreover, even if not dismissed at the outset, it is the experience of the undersigned that what the lawsuit is really about, and the potential financial consequences it poses, if any, only comes into focus over the lengthy litigation process of discovery – and the relevant factors for making that determination often bear no resemblance to those presented in the initial filing.

Accordingly, recognizing these potential assets and liabilities at fair value at the outset of the matter would be both flawed and misleading. In a majority of the cases, the IASB proposal discussed in the ITC will require recognition of potential liabilities related to transient circumstances. These temporary liabilities often will result in no future cash outflows. We do not believe that it is helpful to users of financial statements to require assets or liabilities to be recorded for what might, and in some instances most likely will not, happen. Without a probable threshold, investors will have to evaluate the merits of large numbers of cases that have no chance of prevailing in the courtroom. Moreover, requiring companies to recognize an obligation could lead to abuse by adversaries seeking to take advantage of the financial impact a lawsuit could have on a company. Thus, an adversary could threaten suit, with the acknowledgement that there only is a 1% chance of winning a billion dollar verdict, and then agree to settle for \$5 million before the suit is filed so that the company can avoid having to recognize a \$10 million potential obligation. Furthermore, even if this "arbitraging" of claims did not occur, the "stand-ready" obligation, if discovered by the plaintiff during the litigation, would no doubt set a new

Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies"

floor for any negotiations over the value of the litigation - thereby almost certainly rendering the reserve inaccurate from the start.

We also observe that utilizing a fair value measurement is an extremely costly and timeconsuming exercise because of the complex nature of litigation. There are dozens of judgments and weightings inherent in evaluating any litigation, and all of them could significantly impact "fair value". For example, factors (some of which may not be readily known) might include: applicable case law and common law, the venue, the practices of the lawyers involved, the practices of the judge and/or magistrate involved, the current political and media environment, potential outcomes of other companies facing similar litigation, seriousness of the alleged damage, prior settlement amounts, the strength of viable legal theories, the outcome of factual disputes, potential defense costs, the presence of third parties - such as government agencies, etc. And, even after all of this time and effort have been invested, a projected outcome is still likely to be inaccurate, especially at the outset of a matter. In addition to all of these considerations, we are unsure of the effect of the new standard on fair value measurements on this measurement process. We understand that this new guidance would require estimation of the theoretical exit price for the transfer of this liability to a third party, including determination of an appropriate risk premium that would be necessary to compensate for the significant uncertainty inherent in such claims.

Under existing accounting standards, the difficult recognition and measurement issues are considered only after it is deemed probable that the plaintiff will prevail. The proposed model, in contrast, would embrace recognition of a lawsuit that has any probability of success whatsoever. In a model that blurs the distinction between traditional notions of recognition and measurement, it is unclear as to how one can differentiate between changes in fair value and correction of errors. With the irregular pattern and intervals in which information relevant to the required valuations becomes available, it would seem logical to assume that the receipt of new information would always be of the former type. However, the caution that accountants and auditors will exercise in the current environment of accounting and auditing scrutiny will make these assessments unduly burdensome and time-consuming. For example, after-the-fact reviews of the valuations could be judged by what the company "should have known" in making the determination as opposed to what information it actually possessed. In addition, we are concerned about how auditors will attest to the accuracy and validity of these measurements, as they are not experts in this area and even experts would find it difficult to corroborate or refute what is inherently a highly judgmental determination.

Omitting the probability criterion for recognition of non-financial liabilities also appears to be in a direct conflict with the accounting concept of a liability as defined in CON 6<sup>2</sup>, which says liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events. The use of probable in CON 6 refers to that

<sup>&</sup>lt;sup>2</sup> Statements of Pinancial Concepts No. 6, "Elements of Financial Statements—a replacement of FASB Concepts Statements No.3 (incorporating an amendment of FASB Concepts Statements No. 2)."

which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved. These definitions by their nature require probability to be analyzed to determine the company's expected outflow. If a liability is not expected or probable, it should not be recognized in the financial statements, for doing so is likely to present a distorted view of an entity's liquidity, working capital, and financial position. Recognition of such items, as a result of the proposed "stand ready" obligation, would contradict the well-understood concepts of liability and probability, and would undoubtedly be misleading and confusing to the user community.

Lastly, we request that the Board engage in a dialogue with knowledgeable attorneys before field testing any proposal to record contingent liabilities at fair value because we believe that there is the potential for unintended economic consequences to corporations defending litigation. We would be pleased to participate in a Professional Education session to explain in greater detail to members of the Board and Staff the perspective we have on the implications of the ITC proposal on accounting for contingencies related to litigation.

We appreciate the opportunity to provide our views to the FASB and IASB on this matter, which we believe to be of critical importance to all constituents.

Very truly yours,

Sandra L. Phillips

Senior Vice President & Associate General Counsel

Chief Litigation Counsel - Pfizer

Thomas L. Dign

Alexander Dimitrief

Vice President & Sr. Counsel for Litigation and Legal Policy - General Electric

Thomas L. Sager

Vice President, Assistant General Counsel and Chief Litigation Counsel - DuPont

Manchil

Mark C. Morril

Pag. Cen

Senior Vice President and Deputy General Counsel- Viacom, Inc.

Paul J. Ehlenbach, Vice President & Assistant General Counsel, Litigation The Boeing Company

Jerome N. Krulewitch

JNKtit

Senior Vice President and General Counsel Americas - McDonald's Corporation

James W. Hawkins

Vice President and Chief Litigation Counsel - Kimberly-Clark Corporation

Colvered 1. Weiss

Senior Vice President & Deputy General Counsel-Time Warner

Tayson Va Italli

Thoedore "Taysen" Van Itallie Associate General Counsel – Johnson & Johnson

Dough R. Edwards

Senior Vice President and Deputy General Counsel - Wachovia Corporation

Dennis P. Lynch

Vice President and Chief Litigation Counsel - Tyco International

David Onorato

Deputy General Counsel - Bank of America

George Selby

Corporate Vice President Law - Litigation - Motorola, Inc.





committee on corporate reporting

April 17, 2008

Mr. Robert H. Herz Chairman Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Re: Disclosures about Loss Contingencies-Potential Amendment of FAS 5

Dear Mr. Herz:

The Committee on Corporate Reporting ("CCR") of Financial Executives International ("FEI") wishes to share its views on one particular matter concerning the Financial Accounting Standards Board's ("FASB" or "Board") reconsideration of FASB Statement No. 5 — Accounting for Contingencies ("FAS 5"). Specifically CCR is concerned with the implications this project will have on the accounting and disclosures of loss contingencies related to litigation; particularly the prejudicial impacts these changes will have on ongoing or threatened litigation.

FEI is a leading international organization of senior financial executives. 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. This document represents the views of CCR and not necessarily the views of FEI or its members individually.

FAS 5 has been in existence for over 30 years and represents an excellent example of a principles-based standard. CCR has been carefully following the Board's re-deliberations of FAS 5. We note the Board's views that changing business, legal and regulatory conditions and evolving investor needs and concerns, now warrant a re-consideration of the recognition, measurement and disclosure requirements of FAS 5. At this time we are not suggesting that the other contingencies in the scope of FAS 5 should not be vetted and we are not taking any position with respect thereto; quite the contrary we believe this is an appropriate project for the Board.

However, CCR is very concerned about any changes to FAS 5's guidance with respect to loss contingencies related to litigation. CCR acknowledges the Board has stated that it does not, per se, intend that any revision of FAS 5 will require disclosures that are prejudicial to the interests of the financial statement preparer. However, we believe that any incremental disclosures, other than a description of the legal action, could potentially be useful to a plaintiff. Further we believe if the expectation of any revision to FAS 5 is for more disclosure that it will be difficult for a financial statement preparer to avoid making disclosures that would, or could, be prejudicial. Accordingly, we strongly recommend litigation be removed from the scope of the project and the current requirements of FAS 5 remain in effect. Our reasons are set forth below.

#### Litigation is different from other contingencies:

We believe loss contingencies related to litigation are very different from all other contingencies within the scope of FAS 5. The other in-scope contingencies tend to be much more operational in nature, lend themselves more readily to reasonable estimation, are frequently more predictable as to timing and cash flows and in general are more of an ordinary course of business item. Litigation on the other hand is anything but operational and ordinary course of business. It is an adversarial situation and subject to a set of legal and judicial processes with the objective being the extraction of funds and other forms of compensation for the plaintiff's benefit. The end result of litigation is frequently very difficult to predict. For example, predicting the outcome of intellectual property litigation has proven to very problematic particularly in markets that do not yet have meaningful judicial or administrative precedents upon which a company and its counsel can predict with reasonable accuracy a specific result. Additionally litigation is often brought for other reasons such as for publicity, negotiating leverage on another matter, political and social agendas, etc. Due to the nature of litigation and the attendant legal processes, whether a company has a measurable liability is inherently uncertain; the degree of such uncertainty being much higher versus the other in-scope FAS 5 contingencies. Therefore a litigation contingency is exceptionally different from any other type of contingency; so much so we believe as to readily justify different accounting and disclosure requirements.

#### Changes to FAS 5 will be harmful to investors:

CCR has consistently supported the Board's objective of continuous improvements to financial accounting and reporting for the benefit of financial statement users. We strongly believe the direction this project is trending will, however, be detrimental to those needs in several respects:

- We believe the FASB is, in effect, asking the wrong question of financial statement users. We expect users would affirmatively respond if the question is "Do you want more information about litigation?" However if the question posed was "Do you want more information about litigation if providing this information aided the plaintiffs and could conceivably cost the Company, and shareholders such as yourself, a lot of money?" We submit the answer to this question is much less clear and will frequently be "no."
- Litigation is Inherently unpredictable; the path towards resolution is long and winding with frequent changes in direction. Major litigation is dynamic and transitory; it has numerous ups and downs and management's assessment will frequently change as new information or legal theories emerge, settlement and trial strategy evolve, venues change, judges are assigned, rulings are issued, etc. Accordingly, assessments of potential litigation outcomes are highly subjective and difficult to provide with any degree of precision. Further, there are situations where for short windows of time it may be tactically advantageous to settle a claim but not so advantageous later. Our concern is that to more fully disclose (versus current practice) and assess four times per year, the status of open litigation mostly provides information useful only to a company's legal adversaries. It is difficult to envision how this information would be useful to a typical investor especially when disclosed without the fuller context that a plaintiff would have.
- Building on the above point, we believe expanded litigation disclosures will frequently lead to investor confusion and poor investor decision making. This is because accurate disclosures are often very technical and best understood by those closest to the situation or by trained attorneys. For example, a company's strategy may contemplate losing at a district court level because it is a necessary procedural step in order to get to an appeals court level where a successful outcome is expected. Likewise litigation strategy may lead a company to take, or not take, certain actions in order to preserve rights for appeal. We could enumerate many additional examples however our point is that expanded disclosures will be difficult to understand without context and inside knowledge. What

may seem to an outside party to be a good, or bad, development may be little more than a routine step in the process. Further to disclose that a company expects to lose in a lower court but will win on appeal is not likely to have a salutary effect on the judges involved. As a consequence investor decisions might be based on an incomplete understanding of the situation – the exact Issue the expanded disclosures are intended to rectify.

In addition, we note that on December 4, 2007 you received a letter from the chief litigators from a number of major U.S. corporations. We concur with the concerns they raised. They raised numerous valid points which are fully consistent with the issues and concerns we have discussed herein.

#### Expanded disclosure conflicts with management's fiduciary responsibilities:

It is the responsibility of the management of every company to do everything that is commercially reasonable to protect the company's assets for the benefit of its shareholders and other investors. One of the ways management carries out this responsibility is by keeping confidential information that could be useful to an adversary. Well managed companies have extensive internal policies which strictly control the dissemination of Information which is harmful to the company's interests. The Board's project to expand loss contingency disclosures is diametrically opposed to these fiduciary requirements. Management always has the option to make voluntary disclosures regarding the status of litigation but should not be compelled to do so beyond the current requirements of FAS 5 and the related practices that have developed over the years. CCR believes that by requiring expanded disclosures which management would frequently view as ill advised, the Board has inadvertently inserted itself into the management process. We do not believe this is what the Board intended but it will be an unIntended consequence of this project's direction.

#### Impact on Attorney-Client and Auditor-Client Communications:

We believe a likely, and unfortunate, outcome of expanded disclosure requirements will be a retardation of attorney-client and auditor-client communications. In the FASB's ideal scenario earlier and more expansive disclosures about the status of litigation will become "the norm". Attorneys, with their responsibility to protect their clients' interests, will need to be cognizent of management's new disclosure obligations. We can easily envision scenarios where a company's litigation counsel becomes more circumspect about the advice and legal analysis they provide to their clients because they will be concerned about the possible need to disclose such. We acknowledge the Board does not seek to prejudice a company's interests as a result of new disclosures and we appreciate that disclosures may be accumulated at a higher level than an individual case. That said, the mere internal gathering of the lower level information necessary for the aggregation may very well be discoverable in due course. Further, both management and litigation counsel will need to be cognizant of management's responsibilities to comply with, and the auditor's responsibilities to enforce FASB pronouncements even if the client would otherwise prefer to avoid these disclosures. It is obvious to us that one way to avoid putting the auditors in this spot is to be more deliberative about the information that is shared with them. We strongly believe neither of the above reductions of information flow is desirable however we believe this is what will frequently result.

# Goal Congruence with the Progress Report of the Advisory Committee on Improvements to Financial Reporting (CIFR):

As you are aware, the initial report of the CIFR committee contained many recommendations with respect to the standards setting process. Among the proposals was the call for expanded pre-issuance field tests by the Board and staff. We believe the FAS 5 reconsideration project as it relates to litigation is an excellent project to apply this CIFR recommendation. We strongly encourage the field testing be conducted before the Exposure Draft is released. Further, as part

of the field test we strongly encourage the Board to include the American Bar Association, or appropriate committee thereof, as part of this process.

#### Summary

CCR is extremely concerned about the guidance we expect the Board will recommend. We believe FAS 5 as it relates to litigation contingencies has worked reasonably well over the past three plus decades and remains an excellent example of principles based accounting. Its requirements and limitations are well understood by all relevant parties and working protocols have emerged over the years. We acknowledge that situations have occurred when companies recognized litigation losses and a review of prior disclosures may not have provided sufficient warning of impending losses. However we suspect that if these situations are analyzed that many of the losses were also unforeseen by management and that the loss occurred due to the difficulty of assessing litigation outcomes process rather than a conscious decision not to provide disclosures. It should be noted however, that there is nothing that prohibits management from making today what might be considered voluntary disclosures on litigation if they consider it appropriate and in the shareholders best interests to do so. We strongly recommend to the Board that there be no changes to the current requirements of FAS 5 as it relates to litigation.

....

We appreciate the Board's consideration of these matters and welcome the opportunity to discuss any and all related matters. We will more fully respond to the Exposure Draft when it is published and we expect to have additional comments at that time. We understand the Board is considering having some roundtable meetings to more fully vet the concerns of the preparer community. We strongly endorse such a step and we would be pleased to participate in any such meetings.

Sincerely,

Amold C. Hanish

Chairman, Committee on Corporate Reporting

A News

Financial Executives International