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Mr. Russell Golden
Technical Director
File Reference No. 1840-100
Financial Accounting Standards Board
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Dear Technical Director,

Citigroup Inc. appreciates the opportunity to comment on the Exposure Draft, *Disclosure of Certain Loss Contingencies*, a proposed Accounting Standards Update of Topic 450 (the "ED" or "Exposure Draft").

Citigroup favors increased transparency of financial statements for the benefit of users, and we support the Board's efforts to improve current disclosures of loss contingencies. We also acknowledge and applaud the Board's thoughtful response, as reflected in the current Exposure Draft, to the serious concerns raised by reporting entities and the legal and accounting community in comments on the prior Exposure Draft, *Disclosure of Certain Loss Contingencies,* an amendment of FASB Statements No. 5 and 141(R), File Reference No. 1600-100, issued in June 2008 (the "2008 Exposure Draft"). The current Exposure Draft remedies or mitigates many of the prejudicial and impractical features of the 2008 Exposure Draft. Nonetheless, we have several remaining concerns with the Exposure Draft.

Our main concerns are as follows:

- *Disclosure of Accruals.* The Exposure Draft requires disclosure of "the amount accrued, if any," without qualification. This is a departure from the balance currently struck in ASC 450, which requires disclosure of accruals only when necessary to make the reporting entity's financial statements not misleading. Accruals reflect the judgment of counsel about the possible loss associated with a litigation-related contingent liability. Disclosure of accruals therefore reveals attorney work product and sets a "floor" for settlement, significantly prejudicing the reporting entity. Because accruals are, by definition, already reflected in the reporting entity's financial statements as a charge to income, this prejudicial disclosure is not necessary in most instances. Only in those unusual circumstances where not disclosing the accrual would make the financial statements misleading should the balance tip in favor of disclosing accruals. We therefore advocate retaining the current ASC 450 standard for disclosure of accruals.

- *Tabular Reconciliation.* Even if the Board were to retain the requirement that accruals be disclosed, requiring a tabular reconciliation of accruals for both annual and interim reporting periods is not advisable for two reasons. First, it is not operational, because time periods for quarterly reporting are too tight for reporting entities to compile the required information timely and accurately. Second, it is prejudicial, because quarterly reconciliation makes it too easy for adversaries to ascertain changes in the reporting entity's assessment of particular cases or classes of matters in relation to recent developments in the matters, to the reporting entity's detriment in settlement discussions.

- *Aggregation.* The Exposure Draft offers confusing implementation guidance about the permissible degree of aggregation, suggesting, for example, that differences in procedural posture, jurisdiction, or timing might make it inappropriate to aggregate liabilities that stem from the same basic operative facts. We disagree and believe that aggregation at a higher level of generality is appropriate, provided there is a rational basis for the aggregation and the basis is clear from the disclosure. Permitting greater aggregation will promote more complete disclosure by mitigating concerns about prejudice in individual matters, particularly where quantitative disclosure is required. For example, the tabular reconciliation, if required, should aggregate all recognized loss contingencies into a single table. Different levels of aggregation should be permitted for different aspects of the disclosure.

- *Disclosure of Remote Contingencies.* We do not believe that disclosure of asserted but remote loss contingencies will be useful to users of financial statements. Because litigation in the United States is inherently volatile, it is inevitable that some small percentage of suits will result in substantially greater loss than predicted by management and the company's counsel. Precisely because it is unpredictable which suits will have such a surprisingly adverse outcome, requiring disclosure of all matters that pose a remote possibility of a severe impact will necessarily result in significant over-disclosure, increasing the "noise" in financial statements without providing users with information they can act on. At the same time, the disclosure would be potentially prejudicial to reporting entities, because it would reveal internal judgments about the potential severity and materiality of the claim.

- *Prejudicial Exemption.* We appreciate the Board's efforts to accommodate in the Exposure Draft the very serious concerns about prejudice raised in comments on the 2008 Exposure Draft. As noted above, however, these concerns have not been completely addressed in the current Exposure Draft. To avoid having disclosure requirements actually worsen outcomes in the contingency disclosed—a result that the Board has said it wishes to avoid—the prejudicial exemption in the 2008 Exposure Draft should be reinstated and its use should be permitted whenever, in the opinion of the reporting entity's legal counsel, an otherwise required disclosure would convey to a claimant or potential claimant information that would impede the reporting entity's effective defense or settlement of the claim, unless failure to disclose the prejudicial information would make the financial statements materially misleading.

- *Impact on Loss Contingencies Other Than Litigation.* The intended effect of the proposal on loss contingencies other than those arising from pending or threatened legal proceedings is unclear, particularly whether the Exposure Draft is intended to apply to loan loss reserves and how it would apply to tax contingencies. We would recommend that the Board clarify which loss contingencies are in scope and provide an example of disclosure for a contingency that is not litigation-related. We support the exclusion of loan loss reserves and loss contingencies related

to guarantees, other than product warranties, from the scope of this Exposure Draft, because they are already addressed in Accounting Standards Update No. 2010-20 and ASC 460 (formerly FIN 45), respectively.

- *Implementation Date.* We believe that the proposed implementation date of fiscal years ending after December 15, 2010 is not operational. In particular, the proposed changes to ASC 450 may require changes to the ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information and the AICPA Statement of Auditing Standards No. 12 (together, the "Treaty"). It will take some time for the legal and accounting professions respectively to consider, negotiate, and adopt any required changes to the Treaty.

As stated in our comments on the 2008 Exposure Draft, we believe that the current requirements for disclosure of loss contingencies in ASC 450 strike an appropriate balance between transparency for users and avoidance of prejudice to reporting entities and should not be changed. If the Board were to amend ASC 450, however, we would strongly recommend that:

- the current ASC 450 standard on disclosure of accruals should be maintained;
- tabular reconciliation should not be required, but if required, it should be required only annually, and aggregation of all recognized loss contingencies should be permitted in the tabular reconciliation;
- aggregation should be permitted at any rationally-based level of generality, giving reporting entities wide discretion in this regard particularly with respect to any required quantitative disclosure (e.g., of estimates or accruals);
- disclosure of remote contingencies should not be required;
- a prejudicial exemption should be reinstated;
- the impact on loss contingencies other than litigation should be clarified; and
- implementation should be deferred until no earlier than fiscal years ending after December 15, 2011.

Below we discuss our concerns in greater detail.

Disclosure of Accruals

By definition, when a reporting entity establishes an accrual for a loss contingency, the reporting entity has determined that a loss is probable and has estimated the possible loss or range of loss. The fact that an accrual has been established thus reveals that the reporting entity regards a loss as probable, and the amount of the accrual reveals the reporting entity's assessment of the magnitude of loss. In the context of litigation, this assessment invariably reflects the assessment of the reporting entity's counsel, which would be privileged unless disclosed. In the hands of a litigation adversary, this information would be used to weaken the reporting entity's defense or negotiating position. For example, an adversary may argue to a court or jury that the accrual represents an admission of liability, or probable liability, and that the amount of the accrual represents the defendant's own assessment of the minimum amount for which it is liable. Moreover, even if the accrued amount represents a "best estimate" rather than the

low end of a range, the adversary will perceive the accrued amount to be the floor for any settlement, because it represents both what will be perceived to be the minimum amount the reporting entity believes the claim to be worth and money that has already been "set aside" for the liability. Accordingly, disclosure of an accrual in a manner that enables the reporting entity's adversary to tie a particular accrual to a particular legal proceeding is inherently highly prejudicial and will result in a worse outcome in the proceeding than would have been obtainable without the disclosure.

ASC 450 currently requires disclosure of accruals only when "necessary for the financial statements not to be misleading." ASC 450-20-50-1. Such circumstances are likely to be rare, because the accrual is already embedded in the financial statements as a liability and a charge to income. *See* ASC 45-20-25-2. This rule is sound; it avoids prejudicial disclosure of the fact or amount of accruals unless failure to make that disclosure would be misleading to users of the financial statements. We do not believe there is any benefit to users in other circumstances that outweighs the prejudice to reporting entities from compelled disclosure of accruals. Accordingly, we believe that *the current standard for disclosure of accruals should be retained*.

Tabular Reconciliation

The tabular reconciliation requirement poses the risk of significant prejudice to reporting entities for the same reasons noted above with respect to disclosure of accruals generally. This risk is heightened by requiring tabular reconciliation in interim as well as annual reporting periods. Disclosure of changes in accruals at quarterly intervals will make it easier for adversaries to correlate accrual adjustments to recent developments in a particular matter and thus to infer how the reporting entity's assessment of its exposure has changed in light of those events.

For example, if in a particular quarter a reporting entity's motion for summary judgment in a matter is denied and the entity increases its accrual for the matter by $1 million, the plaintiff will be able to infer from the $1 million increase disclosed in the entity's tabular reconciliation that the entity views its potential liability to have increased by at least $1 million because of the denial of summary judgment. The plaintiff would therefore increase its settlement demand by at least $1 million. While the plaintiff likely would have increased its settlement demand by some amount after summary judgment was denied in any event, without the disclosure in the tabular reconciliation the reporting entity would not face the argument that it itself recognized that its liability had increased by at least $1 million.

This problem would be mitigated to some extent by requiring a tabular reconciliation only in the annual report, because it would be more difficult to correlate changes in accruals to particular events over a longer span of time. But the prejudicial impact of disclosing accruals and changes in accruals would not thereby be entirely eliminated.

Similarly, permitting the tabular reconciliation to be aggregated at the highest possible level of generality (total recognized loss contingencies) would mitigate the prejudicial impact somewhat for some reporting entities. For those reporting entities with only one piece of litigation, or one that dwarfs all others in its portfolio, however, aggregation would not be helpful, as discussed more fully below.

For these reasons, we believe that a *tabular reconciliation should not be required*. If the Board nonetheless decides to proceed with a tabular reconciliation in some form, we would recommend that it be required only in the annual report and that reporting entities be permitted to aggregate all recognized loss contingencies in the same table.

Aggregation
We have three principal concerns about the approach to aggregation in the Exposure Draft.

First, the Implementation Guidance is confusing as applied to litigation. For example, the Exposure Draft says "it may not be appropriate to group together in one class loss contingencies that have significantly different timings of expected future cash outflows." (ED par. 13, 450-20-55-1A.) The timing of future cash outflows associated with litigation is extraordinarily difficult to predict. Litigation arising from a company's manufacture or sale of a single product, for example, may continue for many years or even for decades (as in the case of asbestos), yet it surely ought to be permissible to aggregate all litigation relating to that product, notwithstanding significant variation (and unpredictability) in the speed with which individual matters within that category will be resolved. Similarly, the Exposure Draft's suggestion that it might not be appropriate to aggregate "amounts related to individual litigations with those related to class-action lawsuits or to aggregate litigations in jurisdictions that have different legal characteristics that could affect the potential timing or the potential magnitude of the loss" (*id.*) does not correlate to how we believe users assess litigation risk. A user is more likely to group litigation matters by the source of the risk—e.g., product, line of business, event—rather than to differentiate among individually immaterial matters based on procedural posture, jurisdiction, or timing. We believe that reporting entities ought to be given broad discretion to aggregate matters on any rational basis, provided that the basis is articulated in the disclosure and is not misleading. While we understand that the Implementation Guidance is illustrative and not prescriptive, we believe that the language after the first sentence in the proposed ASC 450-20-55-1A is more confusing than helpful and should be omitted.

Second, it appears that the Exposure Draft envisions that the same classification would be used for all required disclosures, including the disclosure of accruals and the tabular reconciliation. As noted above, we do not believe that disclosure of accruals should be required when not necessary to make the financial statements not misleading, and we believe that the tabular reconciliation should be eliminated—but if these requirements are retained, we believe that reporting entities should be able to aggregate these highly prejudicial quantitative disclosures at a higher level of generality than may be appropriate for qualitative disclosure of the same matters.

Third, as discussed in relation to tabular reconciliation above, aggregation is not a cure-all for prejudice. For some reporting entities in some circumstances, the ability to aggregate may lessen the risk of prejudice associated with certain disclosures, such as the fact and amount of accruals, by obscuring the link to particular matters. Aggregation will not be effective, however, in circumstances where the reporting entity has only one or a very few material litigation matters, or where a single litigation dwarfs all the others in potential exposure.

Accordingly, we recommend clarifying the Exposure Draft to provide that *reporting entities have broad discretion to aggregate in the manner they believe is most appropriate, and may aggregate some disclosed information at a higher level of generality than other information* in order to mitigate the prejudicial impact of the disclosure, provided of course that the disclosure as a whole is not misleading.

Disclosure of Remote Contingencies
Disclosure of remote contingencies would clutter financial statements with extraneous information without enhancing users' ability to understand the financial condition of the reporting entity. Precisely because the likelihood that these contingencies will result in a loss is slight, most of them will never result in any loss, let alone a "severe impact" on the reporting entity. It is true that litigation, particularly in the American legal system, sometimes unexpectedly results in a loss that has a severe

impact on the reporting entity, and in that event users may be surprised by the outcome, but requiring disclosure of remote contingencies will not eliminate the surprise. If the financial statements disclose an array of remote contingencies that pose the theoretical risk of a severe outcome, the user will be no better able to determine which of the remote contingencies disclosed will actually result in a severe loss than it would have been without disclosure. The disclosure is thus likely to be either alarmist or confusing, suggesting that the entity faces more litigation risk than it actually does, or useless, because the user will disregard disclosure of remote contingencies altogether.

The Exposure Draft is also unclear about how the likelihood of a severe impact is to be weighed in determining which contingencies to disclose. For example, suppose that a reporting entity faces two contingencies, A and B. In both the risk of a loss is judged to be 15% (i.e., remote). The maximum potential loss in Contingency A is $1 billion, which would have a severe impact on the reporting entity, but the outcome is completely binary—i.e., there is an 85% chance of no loss and a 15% chance of a $1 billion loss. The maximum potential loss in Contingency B is also $1 billion, but the potential outcomes are not binary—i.e., there is a range of potential outcomes between $0 and $1 billion—and the risk of a $1 billion loss is judged to be only 1% and the risk of loss at lower amounts that are not severe is 14%. Must the reporting entity disclose both Contingency A and Contingency B because both pose a remote risk of a severe outcome? Or may it take into account that the risk of a severe outcome in Contingency A is 15 times greater than in Contingency B? If the reporting entity must disclose without regard for how remote the potential severe impact is viewed to be, the result will be disclosure of contingencies that are not, on any probability-weighted basis, in any way material to the financial results of the reporting entity.

This disclosure would also come at a cost to the reporting entity. It would reveal to adversaries that the reporting entity views the potential outcome of the contingency as not only material but "severe." This prejudicial disclosure of the entity's internal (and otherwise privileged) legal assessment of the risk would tend to drive up settlement costs for remote contingencies, to the detriment of the reporting entity and its stakeholders, without any countervailing benefit to users.

We are highly skeptical that any surprise to users would be avoided by the proposed disclosure of remote contingencies. Because litigation typically develops over a long period of time, many contingencies where a reporting entity initially regards the likelihood of loss as "remote" may later be viewed as "reasonably possible" or even "probable" because of adverse developments in the case. (The reverse is, of course, also true.) When this occurs, under the current disclosure standard, the reporting entity should disclose the litigation in the reporting period when it first deems the risk of loss to be reasonably possible. For a contingency to go from "remote" to a severe loss without intervening opportunities for reassessment and disclosure is rare. Accordingly, we believe that limiting disclosure to contingencies for which the risk of loss is at least reasonably possible is sufficiently protective of users and avoids overburdening them with information about unlikely losses. *Disclosure of remote contingencies should not be required.*[1]

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[1] We note that the Exposure Draft proposes disclosure of "asserted but remote loss contingencies." (ED par. 8, ASC 450-20-50-1D.) Outside the context of litigation, we cannot think of any other remote contingencies that could be "asserted." If the Board intends to require disclosure of non-litigation-related remote contingencies, it should clarify what types of contingencies are within scope. We would recommend, however, that disclosure of remote contingencies, if required at all, should be restricted to litigation matters.

Prejudicial Exemption
Transparency for users of financial statements is a laudable goal, but in the context of loss contingencies that goal is sometimes in conflict with other important goals, such as a reporting entity's ability to defend itself effectively in litigation. We do not believe that accounting rules should drive litigation outcomes. Moreover, we believe that the Board itself supports that principle and has attempted to embody it in the Exposure Draft. *See* Minutes of Aug. 19, 2009 Board Meeting, pars. 20(d) ("Disclosure about the contingency … generally should not affect the outcome of the contingency itself to the detriment of the entity"), 29. While the elimination of much of the predictive disclosure required under the 2008 Exposure Draft has gone a long way to reduce the risk of prejudice to a reporting entity, the risk has not been eliminated. In particular, the requirement to disclose accruals, even when not necessary to make the financial statements not misleading, proposed in the current Exposure Draft may also materially adversely affect the outcome of a loss contingency to the reporting entity's detriment, as discussed above. The proposed requirements to disclose certain remote contingencies and insurance information also may prejudice a reporting entity. For this reason, if the Board does not eliminate these requirements, *a prejudicial exemption should be reinstated*.

Impact on Loss Contingencies Other Than Litigation
The relationship of the Exposure Draft to loan loss reserves, particularly in light the Board's other recent guidance on that subject, is unclear. The Exposure Draft states that the proposed disclosures "amend the guidance on disclosure of certain loss contingencies" in Codification Subtopic 450-20, *Contingencies – Loss Contingencies*. But on July 21, 2010, the Board issued Accounting Standards Update No. 2010-20, *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses,* with the objective of improving disclosures a creditor provides about the allowance for credit losses and the credit risks inherent in its portfolio of financing receivables. This Update adds the following language to Codification Subtopic 450-20:

"450-20-50-2A The disclosures required by paragraphs 450-20-50-3 through 50-6 do not apply to loss contingencies arising from an entity's recurring estimation of its allowance for credit losses."

The above paragraph is not included in the Exposure Draft. While the Exposure Draft would replace subsections 450-20-50-3 through 50-6, it does not make clear whether contingencies relating to the allowance for credit losses would continue to be excluded from the proposed disclosures. Therefore, we ask the Board to clarify that the Exposure Draft would not apply to contingencies related to the allowance for credit losses, as described in paragraph 450-20-50-2A.

We likewise support the exclusion of guarantees, other than product warranties, from the Exposure Draft, because ASC 460 (formerly FIN 45) already addresses in detail the extensive disclosure requirements for guarantees.

As a general matter, it is unclear what types of loss contingencies, other than litigation, the Exposure Draft is intended to address and how the proposed disclosure requirements, which focus heavily on litigation, would apply to non-litigation contingencies. For example, although uncertainty in income taxes is excluded from the scope of the Exposure Draft, there are many other types of taxes (e.g., payroll tax, value added tax, withholding tax, gross receipts tax) for which loss contingencies are accrued. These taxes are often the subject of audits by taxing authorities involving review of documentation and interpretation of law. The issues discussed above relating to prejudicial impacts to the reporting entity in litigation could have an equally prejudicial impact on tax authority audit assessments. It would be

helpful for the Board to provide *additional guidance for reporting entities, including clarification of what is in scope and some examples of disclosure as applied to other contingencies*.

Implementation
Implementation of the Exposure Draft for fiscal years ending after December 15, 2010 is not operational. The Board will presumably want to redeliberate in the wake of the comments received on the Exposure Draft; thus it will not be until late this year, at the earliest, that the ultimate Accounting Standards Update will be issued. If the proposed changes to the current disclosure regime described in the Exposure Draft are retained in the Update, reporting entities will need to gather a substantial amount of additional information and to undergo for the first time an audit of their new disclosures with external auditors that likewise have never before audited the full range of such information. Adequate documentation and controls will need to be created to ensure the accuracy and integrity of this process from both the reporting entity and the auditor perspective. Moreover, because the audit process will require that the external audit team verify new categories of information with outside counsel, the Treaty governing the provision of information by counsel to the auditors may need to be re-examined and possibly amended, a potentially lengthy process. Providing only a few months at best for all of this work to occur before implementation is not realistic. *Implementation should be delayed* until no earlier than fiscal years ending after December 15, 2011.

Other Issues
There are other concerns with the Exposure Draft that we believe others will comment on, and we therefore will not belabor them here. One of these is the requirement to disclose loss contingencies without regard for insurance recoveries, but also to disclose the insurance available to respond to the claim if it is discoverable. This requirement is prejudicial and unnecessary. In litigation, one is often required to disclose to the plaintiff insurance coverage that may respond to the claim, but one is seldom required to do so in a manner that makes the information publicly available, and juries generally are not permitted to know whether the claim is covered by insurance. Requiring disclosure of this information in a public document is tantamount to requiring reporting entities to advertise their insurance program to the plaintiffs' bar so that the depth of the reporting entity's pockets can be assessed. We believe that it makes more sense to permit reporting entities to consider the availability of insurance (including the strength or weakness of the insurance claim and the likelihood of disputes with the carrier) in considering whether a loss contingency is material, but not to require them to disclose available insurance.

Conclusion
We would like to acknowledge again the Board's thoughtful consideration of the concerns raised in comments to the 2008 Exposure Draft. We appreciate the opportunity to comment on the revised Exposure Draft and hope the Board will find our perspective helpful in addressing what are admittedly complex and difficult issues at the intersection of law and accounting. In closing, we would like to emphasize that our single greatest concern about the Exposure Draft is the unqualified requirement to disclose accruals. We strongly urge the Board to consider carefully the serious prejudicial impact of such disclosure on reporting entities and their stakeholders and to retain the current standard for disclosure of accruals embodied in ASC 450-20-50-1.

We would welcome the opportunity to discuss these comments further with Board members and their Staff.

Sincerely,

Robert Traficanti
Deputy Controller and Global Head of Accounting Policy

Michael S. Helfer
General Counsel and Corporate Secretary