

October 22, 2009

FASB Board Members c/o Russell Golden, Technical Director Financial Accounting Standards Board 401 Merritt 7/PO Box 5116 Norwalk, Connecticut 06856-5116

Dear Chairman Herz and Members of the FASB Board,

I have read with interest the recently added statement on the FASB website describing your future course of deliberations on revision of the contingent liability disclosure standard, FAS 5. Of particular note was the statement that further deliberations on litigation disclosures would be directed:

To focus on the <u>contentions</u> of the parties, rather than <u>predictions</u> about the future outcome.

Given the important role that FAS 5 plays in determining accruals and estimates disclosed to investors, this statement could be construed to imply a radical retrenchment from the intent of the accounting rules to provide investors with reasonable information on the amount of a company's contingent liabilities.

If this retrenchment is based on the concern raised by some legal commenters that disclosure of so-called predictive statements may be prejudicial to pending or future litigation, we suggest that FASB instead address this concern through a principled balancing test, analogous to the test commonly applied in legal proceedings. Such a balancing approach would help address the substantial weaknesses of the current accounting system on environmental liability accounting, weaknesses I recently documented in a three part series on my blog, Corporate Disclosure Alert, http://corporatedisclosurealert.blogspot.com.

Notably, the courts do not reject the use of all forms of prejudicial information, but instead use a balancing test in which prejudice is balanced against the usefulness (probativeness) of the information in question. I believe the principled evaluation, "more probative than prejudicial" ought to be applied in FASB deliberations on standards for the types of disclosures to be required under contingent liability reporting. Such an evaluation would need to be applied categorically, not on a case by case basis, to information categories that can be required to be disclosed. In the third installment of my

blog series, I gave examples of categories of information that I believe, consistent with this idea, to be more probative than prejudicial, and which therefore should be required to be disclosed either by the FASB or the SEC. These included emerging scientific concerns about product hazards, litigation results at other firms against which a company's estimated liability can be benchmarked, and the potential for consultants to develop estimates of liability using only other nonprivileged information.

In short, I believe the Board may fail in its quest to *improve upon* the existing FAS 5 and Fin 47 if it does not pursue a more balanced and principled approach to "predictive" and potentially prejudicial information.

Further, some commenters have begun to suggest that the severe shortcomings of financial accounting rules on contingent liabilities might be mitigated by duties of directors to ensure adequate internal controls (*Caremark* fiduciary duties) or the duties of officers to ensure fair presentation of financial information to shareholders (Sarbanes Oxley Act, Section 302). As I noted in my blog, these possibilities do not make up for the shortcomings of current financial accounting rules on contingent liabilities. Instead, they leave reporting companies in a confusing situation of mixed signals and poor guidance, and leave investors exposed to the continued failures of financial reporters to investigate, estimate and disclose their contingent liabilities.

Please contact me if I can assist in further clarifying these points.

Sincerely,

Sanford Lewis

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Counsel

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cc:

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