The **McGraw**·Hill Companies

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Via e-mail

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Technical Director File Reference No. 1840-100 401 Merritt 7 PO Box 5116 Norwalk, CT 06856-5116

Subject: Proposed Accounting Standards Update Contingencies (Topic 450) Disclosure of

Certain Loss Contingencies

Dear Technical Director:

The McGraw-Hill Companies, Inc. ("McGraw-Hill") appreciates the opportunity to provide the Financial Accounting Standard Board (the "Board") with comments on its Proposed Accounting Standards Update Contingencies (Topic 450) Disclosure of Certain Loss Contingencies (the "Proposed Update").

The primary objective of an entity's disclosures for loss contingencies is to provide financial statement users reliable information to form an opinion about the likelihood, amount, and timing of future cash flows and earnings associated with an entity's loss contingencies. Because we believe that transparency for loss contingences is critical to both investors and capital markets, we fully support the Board's efforts to re-evaluate the relevancy of ASC 450-20 *Contingencies*, *Loss Contingencies* ("ASC 450-20").

The need for transparency, however, must be balanced with the need to maintain legitimate confidentiality critical to the entity's effective handling of its loss contingencies. While we appreciate the Board's effort to incorporate comments from the 2008 exposure draft *Disclosure of Certain Loss Contingencies, an amendment of FASB Statements No. 5 and 141(R)* (the "2008 Exposure Draft"), certain changes in the Proposed Update will neither enhance financial statement users' ability to form an opinion about the likelihood, amount, and timing of an entity's future cash flows and earnings from loss contingencies nor make financial reporting for contingent losses more transparent to investors. We believe the proposed financial statement disclosures for remote contingencies could have a severe impact on an entity by increasing the amount of unreliable and irrelevant information included in financial statements. Similarly, summarizing asserted claims at each stage of litigation as events progress erodes the quality and reliability of financial statement disclosures by including information that is inherently uncertain.

Expansion of disclosures for reasonably possible risks

We do not believe the proposed changes for "reasonably possible" loss contingencies in the Proposed Update enhance financial statement users' ability to assess the likelihood, timing, and amount of future cash flows and earnings associated with an entity's loss contingencies. Repeating the allegations in a plaintiff's complaint will necessarily result in including false,

misleading and incomplete information in financial statements. The Proposed Update apparently is trying to reduce the amount of management bias in an entity's disclosures by enabling financial statement users to form their own conclusions about the likelihood, amount, and timing of future cash flows and earnings. But repeating the plaintiff's allegations will not provide the context, background information or legal analysis necessary to reach an informed conclusion.

While the Proposed Update drastically reduces the amount of prejudicial information required to be disclosed by the Board's 2008 Exposure Draft, we believe the remaining provisions implicitly disclose information that could prejudice an entity's legal strategy. Specifically, the Proposed Update requires an entity to enhance its disclosures by detailing the reasons and rationale for any increase in the likelihood or magnitude of the loss. Such disclosures could enable a plaintiff to learn of changes in the entity's view of its case. As expressed in many comment letters to the Board's 2008 Exposure Draft, the disclosure of even seemingly minor prejudicial information is potentially extraordinarily detrimental to an entity's defense against contingent losses. It is also generally difficult for counsel to accurately assess the magnitude or likelihood of a loss in the middle of a contested litigation but the Proposed Update would appear to require the entity's counsel to do just that.

Further, the Proposed Update proposes requiring a specific disclosure of amounts that have been accrued for a loss contingency. The amounts accrued are frequently based on advice subject to the attorney-client privileges based on tentative facts and circumstances subject to dispute during the litigation process. The Proposed Update's provisions permitting aggregation of similar classes of or types of contingences is helpful but inadequate. When contingencies cannot be aggregated, disclosure of the specific amounts accrued could potentially lead to a waiver of attorney-client privilege extending well beyond the computation of potential damages. Disclosure of the specific amount accrued could become a self-fulfilling prophecy by setting a floor for the opponent's expectations of recovery. Even accruals for classes of contingencies can provide useful strategic insights to an opponent, especially if a particular claim is very large or if the particular claim has been added to existing accruals in such a way as to allow identifying the amount of the accrual.

Disclosures for loss contingencies in financial statements are read and considered in a very different context from loss contingencies considered as a litigation matter. Allegations in complaints and even testimony at trial are frequently false or misleading. Litigation uses the discovery and trial processes to evaluate the merits of facts presented and arrive at assessments of liability. In other words, allegations in litigation and assessment of potential losses are inherently conjectural. By contrast, financial statements are generally based on verified or verifiable information. Reporting untested allegations in financial statements would give loss contingencies much greater prominence than warranted.

Remote contingencies

Most troubling, the Proposed Update shifts the focus of ASC 450-20 from providing disclosures of confirmed factual information about contingent litigation matters as of the financial statement date to providing data on speculative assertions. The increased disclosures may provide information that is relevant and useful to litigators, attorneys, and plaintiffs, but extraneous, inconclusive, and misleading for investors. Specifically, expanding ASC 450-20 to include disclosure of remote contingencies that theoretically may have a severe impact erodes the quality and reliability of information included in an entity's financial statements for the following reasons:

- Contingencies are deemed "remote" by management because the underlying claims are frivolous, unsubstantiated, and/or far-fetched. Every large entity has received its share of frivolous lawsuits or demands for unrealistic damage awards. Investors would be disserved by mandatory disclosure of such matters. For example, it would be confusing or misleading to an investor to read of a libel lawsuit seeking \$1 billion if the claim is barred by the statute of limitations or if the damage award would be severely limited by the plaintiff's failure to make a retraction demand. Disclosure of such matters would hand the entity's adversary a tool, useful perhaps in forcing a settlement, regardless of how unlikely such a recovery might be. Expanding the disclosures to include discussions of remote contingencies would therefore erode the quality of information presented to financial statement users for decision making purposes.
- There is little to no correlation between the cash flows and earnings of an entity and the magnitude of damages asserted in remote contingencies. We believe the overriding objective of ASC 450-20 is to provide financial statement users with information on contingences that most accurately portray the potential financial impact of a loss contingency; the amounts claimed by plaintiffs for remote contingencies ranges from zero up to the damages claimed. Providing disclosure of contingent losses for such amounts could unnecessarily mislead financial reporting users to a conclusion that a remote contingency represents a material risk to an investor.
- o Generally accepted accounting principles in the United States of America ("US GAAP") rarely requires prominent disclosure of remote matters comparable to the Proposed Update's disclosures for remote litigation contingencies. US GAAP disclosures generally do not require disclosure of matters that are unlikely to have an impact on an entity. The disclosure treatment for remote contingencies in the Proposed Update would be an exception where US GAAP would require specific disclosure of a matter that is in all likelihood immaterial to financial statement users.
- O Disclosure of remote loss contingencies unnecessarily adds a perception of uncertainty to an entity's financial condition that does not reflect the reality of the claims.

 Unfortunately, a public entity's valuation is impacted by both real and imagined factors. Remote contingencies are among the imagined factors that cause damage to capital markets by creating a distraction for investors, regulators and companies on matters that have only a remote chance of impacting an entity's financial statements.
- O Premature disclosure increases the risk of including false and misleading information in financial statements. Claims in lawsuits presenting remote contingencies frequently are dismissed, in whole or in part, in pre-trial proceedings. Yet, the Proposed Update calls for an entity to include all asserted claims with alleged damages that could have a severe impact on the entity, regardless of merit, for financial statement users' consideration. This disclosure would necessarily increase the amount of potentially unreliable information given to investors. It is unreasonable to expect financial statement users to be able to assess the impact remote contingencies may or may not have on the future cash flows and earnings of the entity. Even a lengthy explanation of contingent claims is unlikely to provide all of the information an investor would need to make an informed opinion. Therefore, disclosure of such remote contingencies would be at least confusing and probably misleading.

Summary

The initial objective of the 2008 Exposure Draft with respect to contingent losses was to provide as much information practicable to enable financial statement users to create as complete a picture as possible to form a conclusion about the likelihood, amount, and timing of future cash flows associated with an entity's loss contingencies. This could not be accomplished without including prejudicial information which the Board recognized could be debilitating to an entity's efforts to successfully resolve loss contingencies and were thus removed in the Proposed Update. While the Proposed Update seeks to avoid providing prejudicial information, the result is proposed disclosures that are unreliable, incomplete, confusing and potentially inaccurate.

We understand the need for investors and other users of financial reporting to obtain timely information to assist in assessing the likelihood, timing, and magnitude of future cash outflows and impact on earnings associated with an entity's loss contingencies. In that regard, we continue to believe that the current framework of disclosure based primarily on management's judgment and assessments balances the needs of investors with the imperative for confidentiality. Disclosure of uncertain, unreliable, or irrelevant information presented during the litigation process is an unsuitable substitute for representations made by management, in consultation with its legal counsel, which investors can rely upon. Financial statements are in substance the representations and assertions of management; the changes in the Proposed Update would require the integration of assertions outside the control of management, whose integrity could not be relied on by investors and should therefore not be included in financial statements. The existing disclosure guidance of ASC 450-20 that relies on management's judgments and estimates, based on both publicly available information and confidential information, continues to be the most practicable mechanism for providing insightful, reliable, and meaningful disclosures for contingent losses.

The attached Appendix includes our detailed response to certain of the Board's questions in the Proposed Update. We appreciate the opportunity to comment and would be pleased to discuss our comments with the Board members or the FASB staff at your convenience.

Emmanuel N. Korakis

Senior Vice President and Corporate Controller

Question 1: Are the proposed disclosures operational? If not, please explain why.

We believe information in financial statements should be accurate, verifiable, reliable and relevant. We do not believe that all claims from litigation, especially during the early stages of asserted litigation, meet these criteria. Before claims and related defenses are included in financial statements, they should be subject to the rigor of the litigation process. We do not believe that investors would benefit from disclosure of erroneous claims.

Question 2: Are the proposed disclosures auditable? If not, please explain why.

To the extent that information included in financial statements is based on publicly available information, the proposed disclosures are auditable. However, we recognize that auditors will request additional information from outside counsel, which depending on the facts and circumstances, may be subject to attorney client privilege as well as prejudicial. As part of the audit process, we will need an adequate time period to evaluate the nature of the auditors' requests and what information can be provided that will not result in compromising the integrity of the treaty created by the ABA Statement of Policy and Auditing Standard No. 12 Inquiry of a Client's Lawyer Concerning Litigation, Claims and Assessments.

The Proposed Update will require additional disclosure of complex legal defense theories, in particular, for instances when entities will be required to disclose their basis for defense for litigation contingencies. Auditors neither have the core competencies to assess the validity of such models nor is it practicable for auditors to acquire such competencies during the short implementation period without an extraordinary cost.

Question 3: The June 2008 FASB Exposure Draft, Disclosure of Certain Loss Contingencies, had proposed certain disclosures based on management's predictions about a contingency's resolution. The amendments in this proposed Update would eliminate those disclosure requirements such as estimating when a loss contingency would be resolved and the entity's maximum exposure to loss. Do you agree that an explicit exemption from disclosing information that is "prejudicial" to the reporting entity is not necessary because the amendments in this proposed Update would:

- a. Not require any new disclosures based on management's predictions about a contingency's resolution
- b. Generally focus on information that is publicly available
- c. Relate to amounts already accrued in the financial statements
- d. Permit information to be presented on an aggregated basis with other similar loss contingencies?

If not, please explain why.

We believe the Proposed Update requires public disclosure of tentative conclusions that are based on prejudicial information or information that is effectively the work product of matters subject to attorney client privilege. In addition, specific disclosure of amounts accrued, except in certain circumstances, for potential losses are a new disclosure that substantively provides a prediction about a contingency's resolution. Based on these considerations, where such matters have been determined based on prejudicial information and are the result of a work product that is subject to

attorney-client privilege, we recommend that the proposed Update include an explicit exemption that can be exercised based on consultation with an entity's counsel.

Question 4: Is the proposed effective date operational? If not, please explain why.

The ability to effectively implement the changes in the Proposed Update for fiscal periods ending on or after December 15, 2010 will depend on the length of the Board's comment letter analysis period, the Board's deliberations, any changes that may be made, and when the final guidance is issued. Given the current proposed disclosure requirements and that we have a calendar year-end, we do not anticipate that one fiscal quarter will be adequate time to permit gathering required information to provide a complete, robust disclosure.

For example, entities will need adequate time to consider with their counsel what information related to remote contingencies that could have a severe impact on an entity is privileged to assess what is appropriate for disclosure as well as what is appropriate to share with an entity's outside auditors. In consideration of the importance of confidentiality for litigation contingencies, the analysis will be time intensive and iterative process that involves an entity's internal counsel, external counsel, outside auditors and finance group.

Question 5: Do you believe that the proposed disclosures will enhance and improve the information provided to financial statement users about the nature, potential magnitude, and potential timing (if known) of loss contingencies?

While the proposed disclosures will increase the amount of disclosures for loss contingencies, we do not believe the proposed disclosures will improve the information provided to financial statement users about the nature, potential magnitude, and potential timing of loss contingencies. We believe the information proposed will effectively erode the quality of the disclosures for loss contingencies by requiring information that has not been evaluated in the context of the legal discovery process.

Specifically, claims made in connection with remote loss contingencies and loss contingencies during the early stages of litigation are frequently determined to be inadmissible, erroneous or irrelevant during the discovery process; therefore disclosing claims and related defenses and providing periodic updates constructively results in providing investors with unreliable information to make an assessment about the likelihood, timing, and magnitude of future cash outflows associated with loss contingencies.