



401 Merritt 7, P.O. Box 5116, Norwalk, Connecticut 06856-5116 | Phone: 203 956-5207 Fax: 203 849-9714

Via Email

August 26, 2010

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

Re: File Reference No. 1840-100

Dear Technical Director:

The Investors Technical Advisory Committee ("ITAC")¹ welcomes the opportunity to respond to the Financial Accounting Standards Board's ("FASB" or "Board") Exposure Draft, *Disclosure of Certain Loss Contingencies* ("2010 ED").² We believe that the 2010 ED, while inferior to the Board's June 2008 Exposure Draft ("2008 ED"),³ would (1) improve the quality of loss contingency disclosures; and (2) strike an appropriate balance between investor information needs and practical concerns of preparers and the legal community.

¹ This letter represents the views of the Investors Technical Advisory Committee ("ITAC" or "Committee") and does not necessarily represent the views of its individual members or the organizations by which they are employed. ITAC views are developed by the members of the Committee independent of the views of the Financial Accounting Standards Board and its staff. For more information about the ITAC, including a listing of the current members and the organizations in which they are employed, see http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1175801857697&pid=1175801857636.

² Disclosure of Certain Loss Contingencies, Contingencies (Topic 450) (Fin. Accounting Standards Bd. Exposure Draft July 20, 2010),

http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=11 75821001041&blobheader=application%2Fpdf [Hereinafter 2010 ED].

³ Disclosure of Certain Loss Contingencies, Proposed Statement of Fin. Accounting Standards (Fin. Accounting Standards Bd. Exposure Draft June 5, 2008), http://www.fasb.org/draft/ed_contingencies.pdf [Hereinafter 2008 ED]. For more information about the ITAC's views on the 2008 ED, see Letter from The Investors Technical Advisory Committee to Technical Director, Financial Accounting Standards Board (Aug. 15, 2008),

http://www.fasb.org/cs/ContentServer?c=Document C&pagename=FASB%2FDocument C%2FDocument Page&cid=1176156443757 [Hereinafter 2008 Letter].

August 26, 2010 Page 2 of 7

More specifically, we agree with the Board that investors and other financial statement users need more and better qualitative and quantitative disclosures about contingencies to assist them in understanding:

- a. The nature of the loss contingencies [,]
- b. Their potential magnitude [; and]
- c. Their potential timing ⁴

As we explained in our comment letter in response to the 2008 ED ("2008 Letter"):

Contingency related disclosures are critical to investors (both current and future) in making buy-sell or hold decisions because frequently they are associated with material amounts or events that have the potential to greatly affect a company's liquidity, capitalization, or business prospects. When investors are not provided timely[] information regarding future losses and the resulting cash outflows, it can result in investors buying a security whose price is shortly thereafter negatively impacted by a "surprise settlement or disclosure." As a result, we believe there is strong justification for the FASB's project.⁵

As indicated, we support the package of disclosures specified in the 2010 ED. We have chosen to target our comments on the following two disclosure items that we believe are especially beneficial to investors: (1) remote loss contingencies with a potential severe impact; and (2) recognized loss contingencies.

Issued well over three decades ago (March 1975) Statement No. 5 is not only among the oldest FASB standards, it also among the poorest in quality. The recognition and measurement criteria embodied in this standard allow managers excessive latitude to decide when, and even *if*, information regarding highly significant risk exposures will be provided to capital providers, and what form that information will take. For example managers and their legal counsel have discretion to decide when the "reasonably determined," "probable" and "reasonably estimable" thresholds are not met and thus, no recognition will be required in the financial statements. These infirmities with a key financial reporting standard were recognized almost as soon as it was issued, and have led to repeated calls over the intervening years by investors and others for a project to be placed on the FASB's agenda to reconsider Statement No. 5 in its entirety and to provide for high quality financial reporting for contingencies and other significant uncertainties.

Letter from Rebecca McEnally, Member, Investors Technical Advisory Committee to Russell G. Golden, FASB Technical Director, Financial Accounting Standards Board 2 (Jan. 15, 2009), http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocument_Page&cid=1176157182792 [Hereinafter 2009 Letter].

5 2008 Letter, *supra* note 3, at 1.

⁴ 2010 ED, *supra* note 2, ¶BC7, at 35. We also believe that investors need better recognition and measurement requirements for contingencies and, thus, the current contingencies standard should be replaced. As noted in our comment letter in response to the Financial Accounting Standards Board's proposed FSP FAS 141R-a: *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination that Arise from Contingencies:*

August 26, 2010 Page 3 of 7

Remote Loss Contingencies with a Potential Severe Impact

It is our understanding that the 2010 ED requires the following disclosures for certain "remote contingencies" that are asserted and subject the entity to "potential severe impact:"6

- 1. Publicly available quantitative information, for example, in the case of litigation contingencies, the amount claimed by the plaintiff or the amount of damages indicated by the testimony of expert witnesses[;]
- 2. Other nonprivileged information that would be relevant to financial statement users to enable them to understand the potential magnitude of the loss[; and]
- 3. Information about possible recoveries from insurance and other sources only if, and to the extent that, it has been provided to the plaintiff(s) in a litigation contingency or it is discoverable by either the plaintiff or a regulatory agency. If the insurance company has denied, contested, or reserved its right related to the entity's claim for recovery, the entity shall disclose the fact.

We support the remote threshold for contingencies disclosure. We agree with the Board that a new threshold is needed to "improve the timeliness of disclosures about loss contingencies." However, we would suggest that the description of the threshold "potential severe impact" be replaced with the phrase "potential material impact." Our aversion to the threshold "potential severe impact" is a result of the dismal experience with that phrase in obtaining timely disclosures of significant risks and uncertainties in Statement of Position 94-6. As more fully explained in our 2008 Letter:

We believe the "severe impact" language of SOP 94-6 should not be adopted within a FASB standard. That is because SOP 94-6 has not resulted in timely disclosures of such events as we have seen during the corporate scandals such as Enron or the more recent sub prime crisis where severe impacts of losses were not disclosed in a timely fashion to investors. Since SOP 94-6 has failed to result in adequate and transparent disclosures, we do not believe it is in the best interests of investors or the FASB to repeat this shortcoming. 10

⁸ *Id.* ¶BC14, at 37.

http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=11 75820920683&blobheader=application%2Fpdf.

⁶ 2010 ED, *supra* note 2, ¶450-20-50-1D, at 10.

⁷*Id.* ¶450-20-50-1F(f), at 12 (underlining omitted).

⁹ Disclosure of Certain Significant Risks and Uncertainties, Statement of Position 94-6, § 10,640 (Am. Inst. Of Certified Pub. Accountants Dec. 30, 1994),

August 26, 2010 Page 4 of 7

Thus, in our view revising the description of the threshold to "potential material impact" would, if faithfully implemented and enforced, achieve the Board and the ITAC's common goal of enhancing the level of information about contingencies. ¹¹ Its use also is appropriate for consistency with the broader and the more conventional application of the materiality threshold in financial reporting.

We also support the three areas of disclosure required for remote contingencies that meet the disclosure threshold, and in particular, the disclosure about "possible recoveries from insurance and other sources." We agree with those March 2009 roundtable participants cited by the Board and other commentators that disclosure of gain contingencies arising from insurance or any other source is "important in assessing the potential magnitude of loss contingencies." ¹³

Recognized Loss Contingencies

It is our understanding that for "recognized (accrued) loss contingencies" the 2010 ED requires disclosure of the following reconciliation by class in a tabular format:

- 1. Carrying amounts of the accruals at the beginning and end of the period[;]
- 2. Amount accrued during the period for new loss contingencies recognized[;]
- 3. Increases for changes in estimates for loss contingencies recognized for prior periods[;]
- 4. Decreases for changes in estimates for loss contingencies recognized in prior periods[; and]
- 5. Decreases for cash payments or other forms of settlements during the period. 14

We support the above disclosure in a tabular reconciliation of recognized loss contingencies. We agree with the Board that the disclosure will be of great benefit to investors who analyze financial statements because the reconciliation provides "valuable information about significant estimates and changes in those estimates that are subject to significant measurement judgment." ¹⁵

¹² 2010 ED, *supra* note 2, ¶450-20-50-1F(f)(3), at 12.

¹¹ *Id*. at 8

¹³ *Id.* at BC25, at 41.

¹⁴ *Id.* ¶450-20-50-1F(g), at 12-13 (underlining omitted).

¹⁵ *Id.* ¶BC26, at 41.

August 26, 2010 Page 5 of 7

We also support the decision of the majority of the Board to require the tabular reconciliation in both interim and annual financial statements. We agree with the majority that "financial statement users generally consider interim information to be as important as annual information." We also would note that the ongoing monitoring of contingencies is, or should be, an integral facet of prudent management. More importantly the significant benefits of timely disclosure of the proposed information would, in our view, outweigh the additional costs to the preparer and auditor that would result from requiring the disclosure in the entity's interim financial statements. ¹⁸

We also support the Board's decision to require that the tabular reconciliation include "loss contingencies initially recognized in a business combination." We agree with the Board that "it was important to include those loss contingencies in the tabular reconciliation because they will result in payments of cash, transfers of assets, or recognition of income for which no corresponding loss was recognized at the time of the initial recognition." ²⁰

The Board's conclusion is consistent with our view that to the extent possible all loss contingencies should be reported in the tabular reconciliation, regardless of their source or nature.²¹ While we may agree with the Board that a singular exclusion from the reconciliation might be justified for loss contingencies whose underlying cause and ultimate settlement occur in the same period,²² we find no legitimate basis for excluding disclosures of contingencies that arise from an acquisition.²³

¹⁶ *Id.* ¶BC29, at 42.

¹⁷ *Id*.

¹⁸ 2008 Letter, *supra* note 3, at 12.

¹⁹ 2010 ED, *supra* note 2, ¶BC30, at 42.

²⁰ *Id*; 2009 Letter, *supra* note 4, at 5 ("This information is necessary to enable investors and other capital providers to adequately evaluate the prospective profitability, cash flows and risks associated with their investments").

²¹ 2008 Letter, *supra* note 3, at 10-11.

 $^{^{22}}$ 2010 ED, *supra* note 2, ¶BC30, at 42 ("The Board reasoned that the short period of time involved in those circumstances raises questions about whether the items meet the definition of a *contingency*"). 23 *Id*.

August 26, 2010 Page 6 of 7

Finally, we hesitantly accept the Board's decision to permit aggregation by class of contingencies in response to the allegations of some corporate lawyers that the tabular reconciliation would prejudice companies participating in litigation. Whether or not those allegations have any merit, we would not support any greater aggregation of the disclosures. As we have explained in previous comments on this general topic:

It is not surprising that preparers and their legal counsel objected to the provision of increased transparency for these significant risk exposures, asserting their long-standing claim that providing such information to those who directly bear the risk from their investments could prove prejudicial to the outcomes of such proceedings and that this risk should trump the investors' desire and, in our view, also entitlement for information about the highly material risks that they bear. ²⁵

. . . .

The failure to provide adequate information to capital providers about such potential risks and uncertainties surrounding their investments in a timely fashion, means that investors will be pricing securities based upon false and misleading information. We believe that to knowingly provide false and misleading information to investors *for any reason whatsoever* amounts to a fraud committed against the investors, is detrimental to the functioning of markets and cannot be permitted for any reason. To do otherwise is to destroy the very faith and confidence that are fundamental to the markets that serve the global economy.²⁶

 25 2009 Letter, *supra* note 4, at 3.

²⁶ *Id*. at 7.

-

²⁴*Id*. ¶BC31, at 42.

August 26, 2010 Page 7 of 7

The ITAC appreciates this opportunity to provide its perspective on the 2010 ED to the Board and its staff. Should you wish further clarification of our views, we would be pleased to respond.

Sincerely,

Investors Technical Advisory Committee By:

Jeff Mahoney Member

Seff Mahnuy

cc: Sir David Tweedie, Chairman, International Accounting Standards Board