



Top Ten Reasons Corporate Counsel Should Be On Alert to the FASB's Proposed Amendments to FAS 5, *Accounting for Contingencies*

The Financial Accounting Standards Board (FASB) released a June 5, 2008 Exposure Draft of proposed amendments to their disclosure requirements in FASB Statements No. 5, *Accounting for Contingencies*, and 141(R). If adopted, these amendments would be effective for annual financial statements issued for fiscal years ending after December 15, 2008, and interim and annual periods thereafter. The greatly enhanced loss contingency reporting requirements, as proposed, call for companies to disclose substantially more information on their litigation loss contingencies, and will create serious issues for companies if passed. ACC is mounting a campaign of interested companies and will be filing comments protesting these proposals (due August 8, 2008). If you'd like to sign your company on, contact ACC's General Counsel, Susan Hackett at hackett@acc.com.

Additional documents, including the FASB's proposals, are online at:
<http://www.acc.com/php/cms/index.php?id=84>

Outlined below are the top ten reasons corporate counsel should be extremely concerned and advising the company's CFO/CEO about the dangers these proposals present.

1. These proposals are a solution in pursuit of a problem.

The current standards aren't broken, and there is no evidence that current disclosure requirements are insufficient or harming market transparency. Adopting significant new and ill-advised proposals without evidence that changes are either necessary or likely to improve disclosures is folly.

2. Heightened disclosure requirements will create unprecedented waivers of the company's attorney/client privilege and work product rights.

Because the proposed amendments will require clients to produce more sensitive and speculative information about possible losses related to litigation, and require earlier production of loss analyses than currently required (namely, before an exposure is well documented or quantified by "facts" as opposed to by an attorney's initial evaluation of possible liability or harm), reporting will likely increase the risk of waiver of privilege and have related punitive effects. These required "qualitative" disclosures will broadly communicate the company's litigation assessments that previously were carefully guarded in adversarial proceedings. Additionally, independent auditors may seek more detail from counsel to test the estimates and disclosures reported, adding to the risk of privilege waiver to auditors.

3. Deeper disclosures of attorney-client privileged assessments will coerce undesirable outcomes in matters on which companies are only asked to report.

The proposed amendments' requirements to provide qualitative assessments of likely outcomes, timing of resolution, and the company's assumptions on loss amounts "give away the store" to any interested adversaries, providing invaluable detail about the company's litigation strategies and settlement coercion-points. The result would be a perverse twist on the FASB's stated desire to disclose more accurate and timely information about loss contingencies: companies' litigation counsel would likely become more circumspect about providing their clients with legal assessments and detailed contingency analyses to assist in their decision-making in order to avoid unnecessary disclosure or liability.

4. Will disclosures themselves be used as admissible evidence in future proceedings on the underlying matters? We hope not, but ...

Reporting requirements, as amended, call for qualitative and quantitative assessments of litigation, including most likely outcomes and estimates of exposure to any litigation in which the chance of loss is more than "remote." These assessments could end up as exhibits in court, with the potential to affect settlement discussions or other possible outcomes.

5. The company would have to report its maximum potential exposure in any adversarial proceeding if the claimant has not been willing or able to quantify it.

Proposed FAS 5's quantitative assessments require a company to provide its "best estimate of the maximum exposure to loss" if a claimant has given "no claim or assessment amount," again providing claimants with information that could drive the outcome of the case with no further work.

6. Requirements to more fully report and assess (four times a year) the status of open litigation will be harmful to investors.

FASB's objective to improve reporting for the benefit of financial statement users, in this case, could hurt the very people it tries to help. Litigation strategies can frequently involve taking a loss in a lower court to position a company for better outcome on appeal, or to preserve rights for appeal, or any number of other courses of action that would not be apparent to anyone but those closest to the proceedings or trained attorneys. Therefore, investors' decisions based on the proposed disclosures could be based on an incomplete understanding of the situation and inappropriately suggest to the markets that which is not what the company wishes to signal.

7. Reporting under the proposed rules would extend to matters in which likelihood of loss is considered “remote.”

These unlikely losses would have to be reported if they are “expected to be resolved in the near term” (*i.e.*, within one year) and may cause “severe impact” (*i.e.*, a “significant financially disruptive effect” on the company’s “normal functioning”). The threshold for “severe impact” is higher than the current “material” standard (“important enough to influence a user’s decisions”), so that’s a relief, but the imposition of rules that require any reporting on “remote” matters that implicate anything less than bankruptcy is both burdensome and dangerous – by definition, it’s ill-quantified or less than likely. And if you don’t report on something remote that you didn’t see as entailing severe impact, you will be subject to the great unwritten rule of second guessing with 20/20 hindsight.

8. The frequency and level of detail for the new disclosures, as proposed, will be unduly cumbersome.

The new reporting requirements create the need for more disclosures, and significantly more detail. Quantitative disclosures include the amount of the claim or assessment (including applicable damages, such as punitive or treble), or, of course, if no amount is claimed, the company’s “best estimate of the maximum exposure to loss.” Qualitative disclosures must include a litany of facts and assessments about the contingency. Additionally, companies must now also include quantitative and qualitative assessment of relevant insurance and indemnification arrangements.

9. FASB’s treatment of prejudicial information is insufficient.

Though FASB attempts to mitigate the potential for release of prejudicial information under the proposed amendments, the solution falls short of preventing disclosures to third parties. FASB would allow, in “rare instances,” a company to “forgo disclosing prejudicial information,” although the company would still be required to provide the amount of the claim and would have to prove that disclosure would broadcast prejudicial information. Thus, potential adversaries will have sufficient information to link the disclosure to a case or subset of cases. The protections offered under these provisions create an inappropriately unavailable threshold by limiting this safe harbor to “rare” cases.

10. Disclosures based on estimates and assumptions that later prove incorrect can, in turn, become sources for additional litigation.

The nature of litigation makes it nearly impossible to predict with much certainty any outcome. Sometimes litigation is not even founded on a factual dispute, but is raised for the specter of publicity, increased negotiating leverage on other matters, business competition or politics, coercion by a plaintiff’s group, etc., thus further complicating accurate analysis. Incorrect disclosures and assessments could provide litigants with future arguments that they relied on disclosures which later turned out to be inaccurate.

And one more for good measure: if adopted in the US by the FASB, the International Accounting Standards Board (IASB) may also adopt these disclosure requirements for their international standards, which are becoming the increasing norm for global businesses.

According to FASB's introductory summary, the IASB is expected to evaluate the disclosure requirements in these proposed amendments when it reconsiders the IAS 37, *Provisions, Contingent Liabilities and Contingent Assets* disclosure requirements, further complicating matters.



As noted, ACC is pursuing a coordinated response to these proposed amendments and welcomes any input you may have. We will prepare comments and testify, and have retained John Villa of Williams & Connolly and Daniel Fischel, former Dean of The University of Chicago Law School and currently a professor (and world recognized commentator on financial disclosure issues) at Northwestern Law School and the Kellogg School of Management. The FASB filing deadline is August 8, 2008, so we would appreciate any comments you have by the end of July. For more information or to share your views, please contact Susan Hackett, ACC's General Counsel (hackett@acc.com) or JD White, ACC's Advocacy Manager (white@acc.com).