Private Company Financial Reporting Committee
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JUDITH H. O'DELL
Chair

August 8, 2008

Mr. Robert Herz
Chairman
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856

Re: Proposed Statement of Financial Accounting Standards, *Disclosure of Certain Loss Contingencies*

Dear Mr. Herz:

The Private Company Financial Reporting Committee ("PCFRC") provides the following comments about the FASB's Exposure Draft of a proposed Statement of Financial Accounting Standards, *Disclosure of Certain Loss Contingencies* ("proposed Standard".)

Summary of our Comments

The PCFRC believes that the existing disclosure requirements of FASB Statement No. 5, *Accounting for Contingencies* ("FASB Statement No. 5"), and Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties* ("SOP No. 94-6"), when properly implemented, provide adequate information to users of private company financial statements about loss contingencies. In the words of a PCFRC member who represents lenders ─

> "*For private companies, the current disclosures as required by FASB Statement No. 5 and SOP No. 94-6 provide sufficient data for bank credit, risk review, loan review and regulators to make a fair and informed decision on verifiable information about the credit quality of a potential or current borrower.*"

Therefore, a need for additional disclosures about loss contingencies does not appear to exist in the private company sector. In reviewing the proposed

Standard, the PCFRC believes that loss contingency disclosures should be focused on and limited to “factual and verifiable information.” As stated by a lender member of the PCFRC,

> “*What bank users desire in disclosures are consistency, comparability, verifiability and understandability at a reasonable cost.*”

Users of private company financial statements need to be aware of loss contingencies, including litigation, claims, and assessments; and those users need to know the essential facts about those loss contingencies. However, disclosures based on speculation, conjecture, and undue estimation are not beneficial to private company financial reporting users and may actually provide information that is used inappropriately by them. Moreover, such disclosures could place a significant cost burden upon private company financial statement preparers and practitioners. Private companies do not enjoy the in-house legal and professional resources of public companies and therefore will incur a disproportionate share of the cost of the proposed disclosures.

Specifically, if there is no claim or assessment amount, a private company should not be required to disclose a best estimate of the maximum exposure to loss. In addition, the qualitative disclosures required by the proposed Standard are excessive. Disclosures should be limited to the facts about the contingency and management’s evaluation of the contingency. Information based on speculation and undue estimation could lead to confusion and a disproportionate amount of emphasis placed on claims with potentially no basis. While this may be meaningful in the fuller presentation of Management Discussion and Analysis for a public company, it would not be appropriate for inclusion in the notes of private company financial statements.

Also, the PCFRC believes that the proposed disclosures could provide prejudicial information that could be detrimental to private companies. Since the majority of private companies have only a few loss contingencies in a given reporting period, aggregation does not protect the private company from providing prejudicial information.

Below are specific comments, as they relate to private companies, on certain questions posed by the FASB in the Exposure Draft of the proposed Standard. The PCFRC is commenting on those questions which have the most relevance to its constituents. As such, certain numbered questions have been omitted.

Specific Responses to Questions Asked in the Exposure Draft

1) Will the proposed Statement meet the project’s objective of providing enhanced disclosures about loss contingencies so that the benefits of those disclosures justify the incremental costs? Why or why not? What costs do you expect to incur if the Board were to issue this proposed Statement in its current form as a final Statement? How could the

Board further reduce the costs of applying these requirements without significantly reducing the benefits?

As currently written, the proposed Standard would not meet the objective of providing enhanced disclosures about loss contingencies so that the benefits of those disclosures justify the incremental costs in the private company sector. The proposed Standard contains certain disclosure requirements that involve speculation, conjecture, and undue estimation. Users of private company financial reporting derive benefit from disclosures that contain factual and verifiable information. Further, a disproportionate cost burden is placed upon private company financial statement preparers and practitioners when they are required to prepare, audit, review, or compile disclosures that are based on undue estimation and speculation.

Quantitative Disclosures

The proposed Standard's requirements in paragraph 7(a) to provide quantitative information about an entity's exposure to loss from a contingency and, more specifically, the requirement for an entity to provide a "best estimate" of the maximum exposure to loss would not be beneficial in the private company sector. Private companies should be required to provide factual quantitative information about exposure to loss from a contingency if that information is reasonably ascertainable (for example, the claim amount filed in connection with litigation or a proposed fine for an environmental infraction.) Private companies should not be required to provide an estimate of the exposure to loss if such an estimate cannot be made. Requiring a private company to provide a best estimate of the exposure to loss could result in disclosures that are nothing more than speculation and conjecture. Such disclosures, far from being beneficial to financial statement users, may actually be detrimental to their decision-making because disclosures based on speculation and conjecture are not reliable or relevant.

Qualitative Disclosures

The proposed Standard's requirements in paragraph 7(b) addressing disclosures about qualitative information are excessive for private company financial reporting purposes. Private company financial statement users are best served if disclosures about loss contingencies consist of factual information about the nature, background, and status of the contingency and management's evaluation. The following Information, proposed in paragraph 7(b), would generally be excessive, costly, and could be prejudicial ─

- A description of the factors that are likely to affect the ultimate outcome of the contingency along with their potential effect on the outcome.

- The entity's qualitative assessment of the most likely outcome of the contingency.
- Significant assumptions made by the entity in estimating the amounts disclosed in paragraph 7(a) and in assessing the most likely outcome.

Such information would tend to be based on speculation and conjecture, which would not be reliable or relevant to financial reporting users.

Preparing and then subsequently auditing, reviewing, or compiling the disclosures bulleted and described above would be a costly undertaking. Many private companies would need to engage outside counsel or other experts to prepare such information, in connection with contingencies related to litigation, claims, and assessments. Although incurring additional costs to make the expanded disclosures would not be unique to private companies, the cost burden would disproportionately fall upon private companies, given their fewer in-house resources compared to public companies.

3) Should an entity be required to provide disclosures about loss contingencies, regardless of the likelihood of loss, if the resolution of the contingencies is expected to occur within one year of the date of the financial statements and the loss contingencies could have a severe impact upon the operations of the entity? Why or why not?

The PCFRC believes that FASB Statement No. 5 and SOP 94-6 require adequate disclosures about loss contingencies, including those expected to be resolved within the near term. For example, paragraphs 13 and 14 of SOP 94-6 (Codification topic 275-10-50-8 and -9) state:

> **50-8** Disclosure regarding an estimate shall be made when known information available before issuance of the financial statements indicates that both of the following criteria are met:
>
> a. It is at least reasonably possible that the estimate of the effect on the financial statements of a condition, situation, or set of circumstances that existed at the date of the financial statements will change in the near term due to one or more future confirming events
>
> b. The effect of the change would be material to the financial statements.
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> **50-9** The disclosure shall indicate the nature of the uncertainty and include an indication that it is at least reasonably possible that a change in the estimate will occur in the near term. If the estimate involves a loss contingency covered by FASB Statement No. 5 (Codification topic 450), the disclosure also shall include an estimate of the possible loss or range of loss, or state that such an estimate cannot be made. Disclosure of the factors that cause the estimate to be sensitive to change is encouraged but not required.

The PCFRC believes that the "reasonably possible" criteria of SOP 94-6 should be maintained. The PCFRC does not believe that additional disclosures are necessary for private company financial reporting.

4) Paragraph 10 of Statement 5 requires entities to "give an estimate of the possible loss or range of loss or state that such an estimate cannot be made." One of financial statement users' most significant concerns about disclosures under Statement 5's requirements is that the disclosures rarely include quantitative information. Rather, entities often state that the possible loss cannot be estimated. The Board decided to require entities to disclose the amount of the claim or assessment against the entity, or, if there is no claim or assessment amount, the entity's best estimate of the maximum possible exposure to loss. Additionally, entities would be permitted, but not required, to disclose the possible loss or range of loss if they believe the amount of the claim or assessment is not representative of the entity's actual exposure.

a. Do you believe that this change would result in an improvement in the reporting of quantitative information about loss contingencies? Why or why not?
b. Do you believe that disclosing the possible loss or range of loss should be required, rather than optional, if an entity believes the amount of the claim or assessment or its best estimate of the maximum possible exposure to loss is not representative of the entity's actual exposure? Why or why not?
c. If you disagree with the proposed requirements, what quantitative disclosures do you believe would best fulfill users' needs for quantitative information and at the same time not reveal significant information that may be prejudicial to an entity's position in a dispute?

The PCFRC does not believe that the change would result in an improvement in the reporting of quantitative information about loss contingencies. The reasons for the PCFRC's belief are stated in the answer to Question 1 above. Quantitative information involving speculation and undue estimation would not be relevant to private company financial statement users. If no amount is associated with a claim, an entity's attempt to estimate an amount may end up being nothing more than speculation and conjecture in many cases. Moreover, the costs of preparing such quantitative information would be a disproportionate cost burden to private company financial statement preparers and practitioners.

5) If a loss contingency does not have a specific claim amount, will an entity be able to provide a reliable estimate of the maximum exposure to loss (as required by paragraph 7(a)) that is meaningful to users? Why or why not?

The PCFRC does not believe that private companies will be able to provide a reliable estimate of the maximum exposure to loss that is meaningful to users. The reasons for the PCFRC's position are described in the answers to Question 1 and Question 4 above. Given the uncertainty inherent in many loss contingencies, the reliability of an estimate of the maximum exposure to loss would be doubtful. Furthermore, an estimate of the maximum exposure to loss would not be a relevant disclosure to users of private company financial information because of the inherent unreliability of the estimate and the very low likelihood of the maximum loss being realized in most cases.

6) Financial statement users suggested that the Board require disclosure of settlement offers made between counterparties in a dispute. The Board decided not to require that disclosure because often those offers expire quickly and may not reflect the status of negotiations only a short time later. Should disclosure of the amount of settlement offers made by either party be required? Why or why not?

The PCFRC believes that disclosure of the amount of settlement offers made by either party should not be disclosed for the reasons stated by the FASB.

7) Will the tabular reconciliation of recognized loss contingencies, provided on an aggregated basis, provide useful information about loss contingencies for assessing future cash flows and understanding changes in the amounts recognized in the financial statements? Why or why not?

In the PCFRC's opinion, the tabular reconciliation would not be useful to private company financial reporting users and would not be worth the cost incurred by preparers and practitioners. Generally, most private companies have very few loss contingencies to account for and disclose. Therefore, the aggregation of information presented by the tabular reconciliation would be superfluous.

In many private company financial statements, it is easy to determine in which lines in the statement of financial position the recognized loss contingencies are included as they are labeled as such. The PCFRC does not believe a required disclosure identifying where in the statement of financial position a loss contingency is included would be onerous.

8) This proposed Statement includes a limited exemption from disclosing prejudicial information. Do you agree that such an exemption should be provided? Why or why not?

9) If you agree with providing a prejudicial exemption, do you agree with the two-step approach in paragraph 11? Why or why not? If not, what approach would you recommend and why?

The PCFRC strongly believes that private companies should not be required to disclose prejudicial information. An entity and its shareholders would be harmed by the disclosure of information that could be advantageously used by counterparties in a dispute. As such, the PCFRC agrees with providing a prejudicial exemption. However, the disclosures required by paragraph 11 of the proposed Standard, despite the use of the prejudicial exemption, could still be prejudicial to a private company's position. The PCFRC believes that private companies should be required to only disclose factual information about the claim amount (no requirement to disclose an estimate of the entity's maximum exposure to loss) and management's evaluation of the claim. Additional information, such as "factors that are likely to affect the ultimate outcome of the contingency" may be prejudicial to an entity's position and therefore should not be required disclosures.

10) The International Accounting Standards Board (IASB) continues to deliberate changes to IAS 37, Provisions, Contingent Liabilities and Contingent Assets*, but has not yet reconsidered the disclosure requirements. The existing disclosure requirements of IAS 37 include a prejudicial exemption with language indicating that the circumstances under which that exemption may be exercised are expected to be extremely rare. This proposed Statement includes language indicating that the circumstances under which the prejudicial exemption may be exercised are expected to be rare (instead of extremely rare). Do you agree with the Board's decision and, if so, why? If not, what do you recommend as an alternative and why?*

Given the substantial, ongoing efforts to converge U.S. GAAP and international financial reporting standards and the trend toward a single set of high quality global financial reporting standards, the PCFRC believes that the language and concepts in new Standards proposed by the FASB should be aligned with language and concepts contained in similar IASB financial reporting standards, to a degree that is appropriate based on the specific circumstances.

That stated, most private companies have only a very small number of loss contingencies that are within the scope of the proposed Standard. Therefore, the PCFRC disagrees with the statement in paragraph 11 of the proposed Standard that it would only be in "rare instances" in which the disclosure of information required by paragraph 7 of the proposed Standard, when aggregated at a level higher than by the nature of the contingency or of the tabular reconciliation would be prejudicial. Rather, the PCFRC believes that in the case of many private companies it is likely that any aggregation of such contingencies, either in textual form or in a tabular reconciliation, would still disclose prejudicial information.

11) Do you agree with the description of prejudicial information as information whose "disclosure . . . could affect, to the entity's detriment, the outcome of the contingency itself"? If not, how would you describe or define prejudicial information and why?

The PCFRC agrees with the description as stated in the proposed Standard.

13) Do you believe other information about loss contingencies should be disclosed that would not be required by this proposed Statement? If so, what other information would you require?

The PCFRC does not believe that other information about loss contingencies should be disclosed.

14) Do you believe it is operational for entities to implement the proposed Statement in fiscal years ending after December 15, 2008? Why or why not?

The PCFRC does not believe that it is operational for private companies to implement the Standard as proposed in fiscal years ending after December 15, 2008. Our February 1, 2008 letter to the FASB about improvements to the FASB's standards release process explained that private companies require more time to implement new standards than public companies. Therefore the proposed Standard should contain a later effective date for private companies than the effective date set for public companies.

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The PCFRC appreciates the FASB's consideration of these comments on the proposed Standard. Please feel free to contact me if you have any questions or comments.

Sincerely,

Judith H. O'Dell
Chair
Private Company Financial Reporting Committee