Defending Liberty
Pursuing Justice

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September 20, 2010

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Proposed Accounting Standards Update, "Disclosure of Certain Loss Contingencies" (the "Revised Exposure Draft"): File Reference No. 1840-100

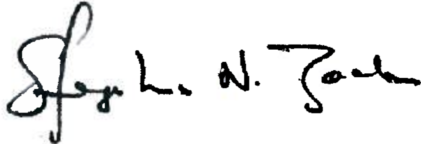
Dear Mr. Golden:

On behalf of the American Bar Association ("ABA"), which has nearly 400,000 members, I am pleased to present our enclosed Comments on the Financial Accounting Standards Board ("FASB" or the "Board") Revised Exposure Draft referenced above. The ABA's Comments were prepared by several leading members of our Business Law Section, including Thomas White (Chair of the Section's Law and Accounting Committee), Stanley Keller (until recently Chair of the Section's Committee on Audit Responses), James Rosenhauer (current Chair of the Section's Committee on Audit Responses), Linda Griggs, Richard Rowe, Catherine Dixon, Randolph McClanahan and Michael Scanlon. Our Comments also include input from in-house and outside lawyers with a broad range of expertise and experience.

As explained more fully in the enclosed Comments, although the ABA commends the FASB for addressing many of our previous comments on the FASB's 2008 initial exposure draft and shares the FASB's goal of providing investors with meaningful and timely information regarding contingent liabilities, we continue to question the need for the FASB to make changes to the existing disclosure standards under Accounting Standards Codification ("ASC") Subtopic 450-20. We also continue to have significant concerns regarding certain aspects of the Revised Exposure Draft. Therefore, if the Board is intent on revising the disclosure standards, we urge it to adopt the further revisions recommended in our enclosed Comments, which we believe would accomplish the objectives of enhanced and timely information for investors without eroding fundamental attorney-client privilege and work product protections or creating unnecessary problems for companies. The ABA also respectfully requests that the FASB adopt a later effective date for the new requirements contained in the Revised Exposure Draft in order to allow companies and their auditors adequate time to implement these changes.

Thank you for considering our views on this critical subject. If you have any questions or need more information, please contact Thomas White at (202) 663-6556 or Stanley Keller at (617) 239-0217.

Sincerely,



Stephen N. Zack

Enclosure

COMMENTS OF THE AMERICAN BAR ASSOCIATION

ON THE

FINANCIAL ACCOUNTING STANDARDS BOARD PROPOSED ACCOUNTING STANDARDS UPDATE TITLED "DISCLOSURE OF CERTAIN LOSS CONTINGENCIES"; FILE REFERENCE NO. 1840-100

September 20, 2010

The American Bar Association[1] ("ABA") is submitting these comments on the Financial Accounting Standards Board ("FASB") Proposed Accounting Standards Update, "Disclosure of Certain Loss Contingencies," File Reference No. 1840-100, issued on July 20, 2010 (the "Revised Exposure Draft").

Introduction

At the outset, the ABA commends the FASB for its responsiveness to the comments that the ABA and others submitted on the FASB's 2008 exposure draft, "Disclosure of Certain Loss Contingencies: An Amendment of FASB Statements No. 5 and 141(R)" (the "Initial Exposure Draft"). The Revised Exposure Draft addresses many of the comments we raised regarding the Initial Exposure Draft. As with this letter, our prior letter dated August 5, 2008[2] focused on loss contingencies involving litigation and claims that could result in litigation. The ABA shares the FASB's goal of providing users of financial statements with meaningful and timely information regarding contingent liabilities. However, we continue to have serious concerns about some aspects of the Revised Exposure Draft. These concerns are based upon the significant prejudicial impact that certain proposed disclosures would have on companies and their investors without, in most cases, providing material information to users of the financial statements. We also are concerned about the risks these disclosures would create for fundamental attorney-client privilege and work product protections, both as a result of the disclosures called for by the Revised Exposure Draft and because of the information auditors may seek in connection with auditing those disclosures. Recent judicial decisions have demonstrated the fragility of these protections when information is provided to auditors. We refer you to our prior comment letter for further explanation of our concerns and discussion of the importance of preserving these protections and the role they play in ensuring legal compliance.

Because of our concerns, as well as those of others, we question the need for the FASB to make changes to the existing disclosure standards under Accounting Standards Codification

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[1] The ABA is the largest voluntary professional membership organization and the leading organization of legal professionals in the United States. The ABA's membership of nearly 400,000 spans all 50 states and other jurisdictions and includes attorneys engaged in legal matters in various settings. The ABA is dedicated to the rule of law, the efficient administration of justice and the preservation of fundamental legal rights.

[2] The ABA's letter to the FASB dated August 5, 2008 and attached Comments regarding the FASB's exposure draft titled "Disclosure of Certain Loss Contingencies: An Amendment of FASB Statements 5 and 141(R)" are available at http://www.abanet.org/poladv/priorities/privilegewaiver/2008aug5_privwaiv_fasb_l.pdf.

("ASC") Subtopic 450-20. We do not believe it has been established that under the existing disclosure standards users of financial statements are failing to receive the information about pending or potential litigation that they need in order to assess a company's financial condition. Our experience is that companies endeavor to provide this information, and therefore we question the underlying rationale for the proposed changes. If the FASB believes that it must take action because of concerns about the adequacy of the implementation of the existing standards, it could consider providing guidance with respect to the disclosures required by the existing standards. If, however, the FASB determines to proceed with changes to ASC Subtopic 450-20, we suggest below revisions to the proposals which we believe are necessary in order to reduce the prejudice to the liability position of companies. We also believe these revisions are necessary to avoid the erosion of the fundamental attorney-client privilege and work product protections that could result from expanded disclosures about loss contingencies. Balancing the objectives of providing disclosure to users of financial statements with preserving these fundamental protections is at the heart of the ABA's Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (the "ABA Statement")[3], which has been in effect for 35 years.

These comments explain our substantive concerns with the Revised Exposure Draft, recommend certain revisions intended to ensure that preparers of financial statements only disclose material and non-prejudicial information about loss contingencies, and set forth our views with respect to the impact of the Revised Exposure Draft on the ABA Statement. In particular, we are concerned about the prejudicial impact on companies of the proposed changes to ASC Subtopic 450-20 that would require disclosure of the amount of accruals and presentation of a tabular reconciliation, as well as of the possible premature disclosure of defenses and information regarding the availability of insurance coverage under the circumstances set forth in the Revised Exposure Draft. We also urge the FASB to defer the effective date of any new requirements to provide companies and their auditors adequate time to plan for the new requirements.

General Considerations

We believe it is useful to set forth some general considerations that provide context for our more specific comments on the Revised Exposure Draft.

- *Principles-based approach.* Because of the complexity and variability of dealing with loss contingencies, the FASB should follow a principles-based approach to establishing disclosure requirements. The Revised Exposure Draft appears to recognize the appropriateness of this approach but then departs from it by unnecessarily mandating detailed disclosures. A principles-based approach, in contrast to a prescriptive approach, affords companies the flexibility to exercise judgment in dealing with disclosures in a complex area where outcomes can be uncertain, especially when those disclosures can be prejudicial to a company's litigation position and harmful to its shareholders.

[3] The ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information, adopted by the ABA Board of Governors in 1975, and the related background report, is available at http://www.abanet.org/buslaw/attorneyclient/policies/aicpa.pdf.

- *Litigation is inherently uncertain.* It is important to recognize that the litigation process, especially in the United States, is fraught with uncertainties. This uncertainty also means that the precision the Revised Exposure Draft sometimes seeks is an illusory goal. The FASB should recognize that it is the uncertainty and unpredictability of litigation, rather than any failure of disclosure, which often accounts for the surprises that users have complained about.

- *Materiality should be the touchstone.* Any disclosure regime must be based upon the bedrock principle of materiality of the information to users. Without this guiding principle, there is a risk that disclosures may mask what is important and, more importantly, may be harmful to companies without providing any corresponding benefit to users. Thus, the criteria for disclosure should not be what might be of interest to a user of the financial statements but rather what is material for users. The inclusion of immaterial disclosures in financial statements undermines established legal and accounting precepts. The existing legal framework focuses on the materiality of disclosures to investors, and the FASB should not be creating a new regime. As an example, the current accounting standard relies on the existing legal framework by requiring disclosures of accruals only when necessary so that the financial statements are not misleading.

- *Disclosures should avoid prejudicing the outcome.* Disclosures of loss contingencies, especially litigation contingencies, should avoid adversely affecting the outcome of those contingencies to the detriment of companies and their shareholders. Thus, information that could be prejudicial should not be required unless that information is necessary so that the financial statements are not misleading.

- *Unnecessary mandated disclosures can themselves become a source of liability exposure.* Requiring disclosure of information that involves speculation or prediction can itself be a source of liability, based upon claims that the disclosure was misleading when results turn out differently than predicted. Merely being named in such a suit can be injurious to companies, regardless of the ultimate outcome. Thus, there can be significant adverse consequences to requiring disclosures that do not meet the materiality threshold. This exposure to liability is exacerbated by the inapplicability of the statutory forward-looking information safe harbor to financial statement disclosures.

- *Priority of protection of attorney-client privilege.* The ABA Statement, along with its counterpart in Statement of Auditing Standard ("SAS") No. 12, were developed to preserve the fundamental protections of the attorney-client privilege while providing auditors an ability to obtain evidential support in connection with the audit process. Thus, the AICPA in AU Section 9337.09 stated that:

> Although ordinarily an auditor would consider the inability to review information that could have a significant bearing on his audit as a scope restriction, in recognition of the public interest in protecting the confidentiality of lawyer-client communications (see section 337.13), section 337.05*c* is not intended to require an auditor to examine documents that the client identifies as subject to the lawyer-client privilege.

These objectives are as important now as they were when the ABA Statement and SAS No. 12 were adopted and need to be preserved.

Specific Comments on the Revised Exposure Draft

Disclosure of Amounts of Accruals and Tabular Reconciliations. The ABA has serious concerns about the proposed requirement for a company to disclose the amount of its accrual for loss contingencies, whether pursuant to proposed paragraph 450-20-50-1F.e.2. or in the tabular reconciliation required by proposed paragraph 450-20-50-1F.g. We believe that requiring this disclosure in all circumstances risks substantial prejudice to a company's defense position in litigation. Such disclosure could provide an adverse party critical insight into a company's views regarding the prospects of the litigation. The amount of any accrual — which will reflect the preparer's judgment that a payment is probable and an estimate of possible loss — inevitably will establish a "floor" for settlement negotiations. An adversary may also seek to assert in court that the amount of the accrual is an admission as to the merits of its claim and the amount of liability. The disclosure of the amount accrued may result in auditors' demands for additional evidence to support a company's accrual. This could result in a waiver of attorney-client privilege and loss of work product protection as to counsel's underlying advice and analysis. The proposed requirement that the amount of the accrual and the tabular reconciliation be provided on a quarterly basis compounds these issues.

In 2000, the Securities and Exchange Commission (the "SEC") proposed to require expanded disclosure about changes in valuation and loss accrual accounts for litigation and other expense items.[4] Many comment letters expressed concern that disclosure of the loss accruals related to probable losses from pending litigation would not be in the best interests of investors. The commenters on the SEC proposal noted that even disclosure of litigation reserves on an aggregate basis, as proposed, would seriously harm a company's litigation position, while at the same time not providing material information to investors.[5] One commenter noted that the materials and analysis underlying the reserve calculation would probably be discoverable in the pending litigation because of the disclosure of the amount of the reserve. The commenter noted that the ability of a plaintiff to obtain access to the company's analysis of the amount of the

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[4] Securities Act No. 7793, "Supplementary Financial Information" (Jan. 21, 2000), available at http://www.sec.gov/rules/proposed/34-42354.htm.

[5] E.g., Letter from Joanne T. Marren, Chair, Federal Regulation Committee of the Securities Industry Association, dated April 24, 2000 (hereinafter cited as the "SIA"); Letter from Philip D. Ameen, Chairman of the Financial Executives Institute Committee on Corporate Reporting, dated April 19, 2000 ("The Commission's proposal could increase the incidence of such lawsuits by providing a needless level of detailed disclosures and "red flags" upon which opponents could pounce.")

reserve would significantly disadvantage the company and its ability to defend the litigation.[6] The SEC did not adopt the 2000 proposal.

We disagree with the suggestion in paragraph BC 35 of "Background Information and Basis for Conclusions" that the disclosure of an accrual and changes in the accrual through the tabular reconciliation would not be prejudicial because the amount of accruals must be disclosed under current requirements. The existing provision, paragraph 450-20-50-1, requires disclosure of the amount accrued "if necessary for the financial statements not to be misleading." This permits the exercise of judgment based on the circumstances, in contrast to the proposed requirements that would mandate disclosure of the amount of accruals in all cases, along with the tabular reconciliation. Proposed paragraphs 450-20-50-1F.e.2. and 450-20-50-1F.g. would eliminate the exercise of judgment and require the disclosure regardless of its significance to an understanding of the financial statements. It is important to recognize that the accrual will already be reflected in the company's financial statements and thus the benefit to users of the added itemization would not outweigh the significant disadvantage to companies resulting from that disclosure.

As explained more fully below with respect to aggregation, the ability to aggregate similar loss contingencies would not avoid the prejudicial impact of the accrual disclosure. The aggregation criteria are too narrow and will likely not be applicable to the larger lawsuits that would be affected most adversely by the disclosure of the defendant's view of its prospects with respect to the lawsuit. Moreover, the ability to aggregate will not assist companies with few pending lawsuits that are material, or with lawsuits that cannot be aggregated, and these companies will have to make potentially prejudicial disclosure.

We recommend that, rather than adopting the proposals to require disclosure of the amount accrued and the tabular reconciliation, the FASB require disclosure of the amount of the accrual only if necessary for the financial statements not to be misleading, consistent with the current requirement. This could be accompanied by guidance indicating that, if the amount has been otherwise disclosed publicly, such as in management's discussion and analysis of financial condition and results of operations, it ordinarily would be expected to be disclosed in the financial statements. Disclosure about the accrued amount would be required by current SEC rules to be included in the management's discussion and analysis if that information is material to an understanding of a company's results of operations, financial condition or cash flow.

If the FASB nevertheless adopts the requirements to disclose the amounts of accruals and to provide a reconciliation of changes in accruals, we believe that these requirements should be modified in several important ways. If adopted, these requirements: (i) should only apply to annual financial statements; (ii) should permit aggregation of the accrual information at the highest level of aggregation — such as the aggregate amount of the accruals for all pending lawsuits and asserted legal claims or the aggregate amount of the accruals for all environmental contingencies — in order to mitigate the prejudicial impact of the disclosures; and (iii) because of the prejudicial impact of the proposed disclosure on companies with few loss contingencies or loss contingencies that cannot be aggregated, should also provide for an exception from the requirement when a company concludes that the disclosure would prejudice its litigation position. Companies relying on the prejudicial exception could be required to disclose, to the extent

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[6] SIA, *supra* note 5.

consistent with the foregoing, information intended to assist investors in understanding the impact of the loss contingency or contingencies on the future operations of the company.

Aggregation Requirements. We disagree with the FASB's assertion in paragraph BC 35 that the ability to aggregate similar claims "would address many of the concerns about having to make prejudicial disclosure." Because the Revised Exposure Draft would permit aggregation only in limited circumstances, it is likely that the disclosure of the amount accrued would advantage plaintiffs in many circumstances to the detriment of defendant companies and their investors. Proposed paragraph 450-20-55-1A of "Implementation Guidance and Illustrations" explains that "it may not be appropriate to aggregate amounts related to individual litigations with those related to class-action lawsuits or to aggregate litigations in jurisdictions that have different legal characteristics that could affect the potential timing or the potential magnitude of the loss" or to "group together in one class loss contingencies that have significantly different timings of expected future cash outflows (that is, near term versus longer term)." This guidance might be interpreted to rule out the aggregation of complaints filed in different states, individual claims with class action claims and claims filed at different times. Rather than calling on the application of judgment, the guidance in practice is likely to be treated as creating a presumption preventing otherwise appropriate aggregation. Moreover, it is likely that in many cases significant claims would not be able to be aggregated. Furthermore, an entity with few claims may be unable to aggregate any of those claims.

As noted above, we recommend that the FASB retain the current requirement pursuant to which companies must disclose an accrued amount to the extent necessary for the financial statements not to be misleading, accompanied by guidance that disclosure of the amount accrued ordinarily would be expected when the company has otherwise disclosed the amount publicly.

Disclosure of "Remote" Contingencies. The ABA disagrees with the requirement in proposed paragraph 450-20-50-1D for disclosure about an asserted but remote loss contingency if it would, if adversely determined, have a severe impact. Once a company concludes that an adverse outcome of a pending lawsuit or other asserted claim is remote, assessing whether the impact of an adverse outcome would be severe, especially in view of the absence of any time horizon for that analysis, would be a theoretical and speculative exercise. We believe such disclosures would be at odds with the SEC's efforts to reduce disclosures of theoretical risks that mask important disclosures. Such a speculative exercise would be inconsistent with the FASB's comment in paragraph BC 19 of the Revised Exposure Draft that it has "decided not to require disclosure of any new information that is based on management's prediction about a contingency's resolution beyond what is already required under current U.S. GAAP as described in Topic 450." We also question whether any disclosure of asserted claims where the likelihood of an adverse outcome is remote, and especially claims where the likely impact would be speculative, would provide any meaningful information to users of financial statements. We also note that, in our experience, a conclusion that an asserted claim is remote is reached infrequently and only after careful consideration. Therefore, remoteness is already a high standard that does not require the addition of an exception. Finally, we are concerned that auditors' will consider it necessary to obtain evidentiary support for the disclosure, which itself would put attorney-client privilege and work product protection at risk.

This requirement also would distort materiality concepts. Materiality, as defined by the Supreme Court in *Basic v. Levinson*, is a combination of magnitude and probability assessments, whereas the FASB's proposed requirement would not permit a weighing of magnitude versus probability. If standards for materiality judgments are to be changed, it should be done by the SEC or the courts and not through the FASB's adoption of accounting standards.

We also are concerned that adoption of a severe impact exception to remote asserted claims would encourage claimants to initiate lawsuits with greatly inflated damages claims so as to use the disclosure requirement to extract a quick settlement from companies that otherwise would contest the claim.

Consistent with principles reflected in existing accounting literature, as well as in the Revised Exposure Draft, companies review the likelihood of an adverse outcome on loss contingencies on a quarterly basis. If, upon any such review (taking into consideration developments with respect to the claim and any related proceedings), a remote asserted claim is considered no longer to be remote but reasonably possible, appropriate disclosure about that contingency will then be made. Accordingly, we do not believe it is necessary to create a severe impact exception for remote contingencies, and recommend that no change be made to the existing standard reflected in Topic 450 not to require disclosure about remote contingencies.

If the FASB nevertheless considers an exception necessary, it should be based upon requiring disclosure of a remote asserted claim if the disclosure would be necessary for the financial statements not to be misleading. This would permit judgment to be exercised based on existing concepts of materiality.

Disclosure About Insurance Coverage and Other Sources of Recoveries. The ABA considers it anomalous that the Revised Exposure Draft would deny companies the ability to take into account insurance coverage and indemnification in assessing materiality while at the same time requiring disclosure of potential insurance and indemnity coverage in many cases. Insurance and indemnification are important and routine elements of a company's risk management program and therefore companies should be able to take such matters into account in assessing the materiality of a loss contingency. This materiality assessment would require a company to determine whether recovery from these sources has the requisite certainty and to disclose any material uncertainties regarding such recoveries. We therefore disagree with the conclusion expressed in paragraph BC 15 that insurance coverage should always be excluded from consideration because it is sometimes uncertain and may be subject to litigation. Rather, this should be a matter for the exercise of judgment by companies, accompanied by appropriate disclosure when necessary.

Whether or not insurance coverage can be taken into account in assessing materiality, we also are concerned that the requirement that insurance coverage be disclosed under the circumstances set forth in proposed paragraphs 450-20-50-1F.e.5. and 450-20-50-1F.f.3. (that is, "if it is discoverable, even if information has not yet been provided to the plaintiff in discovery," as explained in BC41) would inappropriately interfere with the litigation process in several ways, potentially prejudicing the outcome of such litigation and any settlement to the ultimate detriment of shareholders.

First, whether information is discoverable is not an easy determination and can depend on a range of factors, making this a predictive exercise. Moreover, even if information is generally discoverable, it may not be discoverable in a particular situation because there may be defenses to that discovery. It may not be known until a court rules whether any particular information is discoverable.

In addition, the possibility that insurance coverage may be discoverable does not mean that a plaintiff has sought such information. Even if the plaintiff has sought that information, its being provided in discovery does not make the information public. Discovery is generally a private process and, when disclosure of insurance coverage is permitted, it is to permit the plaintiff to assess settlement values. Furthermore, the rules of many courts provide that disclosure of insurance coverage is inadmissible as prejudicial even though a plaintiff may be able to obtain that information in discovery. We are particularly concerned that a requirement to publicly disclose the information if it is discoverable fundamentally misperceives the function of discovery. The discovery process is not to make information publicly available but rather to provide information to the parties about the case.

Requiring public disclosure of otherwise non-public discovery would be harmful to defendant companies because a court could deny a defendant the protection from admissibility if the information has already been disclosed in its financial statements. In other words, the FASB proposed requirement may make admissible in a court proceeding information that, without the FASB requirement, would not have been admissible.

Accordingly, we suggest that any requirement that insurance coverage (or any other discovery information) be disclosed be limited to those situations when the information has actually been admitted into the proceedings. At the very least, there should be no required disclosure of insurance coverage (or any other discovery information) unless the information has actually been provided to the plaintiff through discovery or otherwise or to the government agency whose actions gave rise to the loss contingency (and, even then, not when public disclosure of such information has been precluded by law or a protective order or other judicial action). Because the standard we suggest, as well as the less desirable alternate standard, would be factually based, it would avoid the need for auditors to make legal determinations, through inquiry of counsel or otherwise, whether something is "discoverable" or "admissible" under applicable law. Indeed, whether information is discoverable or admissible is a determination made by courts during the proceeding and is often difficult to predict beforehand.

We also are concerned that the proposal to require the disclosure about possible recoveries "if it is discoverable by . . . a regulatory agency" is vague and subject to confusion. If this requirement is retained, we suggest that this language be clarified to state as follows: "if it is discoverable by either the particular plaintiff or the regulatory agency whose actions give rise to the loss contingency." For the reasons noted above, this also should be conditioned on the absence of defenses to discovery, as well as the absence of any legal bar to such disclosure. This clarification would not be required if the FASB adopts either our suggestion that insurance coverage be disclosed only if it has been previously admitted in a proceeding or the less desirable alternative that insurance coverage be disclosed only if it has been previously provided to the plaintiff or the applicable regulatory agency.

Finally, we believe that 450-20-50-1F.e.5. should make clear that the requirement to disclose whether the insurance company has denied, contested, or reserved its rights related to coverage applies only if such insurance coverage has been otherwise disclosed.

Disclosure of the Amount of the Claim. The requirement in proposed paragraphs 450-20-50-1F.b., 450-20-50-1F.e.1. and 450-20-50-1F.f.1. to disclose the amount claimed by a plaintiff, even if the amount bears little relationship to the allegations or reality, could result in a significant risk of misleading or confusing disclosure. In addition, such a requirement would result in different disclosures depending upon the jurisdiction in which a complaint is filed. Many jurisdictions prohibit inclusion of claim amounts in complaints filed in such jurisdictions precisely because, among other things, such amounts may have little relationship to the factual or legal claims in the complaint and may potentially have a misleading and prejudicial impact. Disclosure of a claimed amount, if permitted by court rules in the complaint, also would be misleading in connection with class actions in view of the issues that often need to be resolved regarding certification of the class and whether the actual class size will be consistent with class size asserted in the complaint. Moreover, as noted above, this disclosure requirement could encourage claimants to make excessively inflated damages claims to achieve settlement negotiation leverage. A defendant company's ability to accompany the disclosure of the amount of the claim with information about why the company believes the amount is unjustified does not mitigate our concerns, because the mere inclusion of an unrealistically excessive claim amount could be misleading to investors. Investors may conclude that the presence of the information in a company's financial statements means the claim meets specified standards and therefore has some credibility that is unjustified. In addition, auditors would likely seek evidentiary support for any mitigating information a company chooses to include in its financial statements, which could itself result in the loss of the attorney-client privilege or work product protection.

We also are concerned that putting companies in the position of having to explain why they believe a claim amount is unjustified would unnecessarily subject companies to ongoing disclosures that provide a roadmap for plaintiffs regarding the litigation to the prejudice of the company and its shareholders.

If the FASB determines to require this disclosure notwithstanding our concerns, we suggest that companies be given the ability to omit the disclosure of the amount of the claim where the company has determined that such omission is necessary to avoid misleading disclosure to users because the amount of the claim bears little relationship to the allegations or to reality.

Additionally, the guidance provided by the FASB should make clear that testimony of expert witnesses is to be taken into account only if that testimony is considered reliable and is admissible under prevailing judicial standards. The Supreme Court in the *Daubert* case established the rule that courts need to be satisfied regarding the reliability of expert testimony before it actually is admissible.

Disclosure of the Contentions of the Parties. The ABA believes that the requirement in proposed paragraph 450-20-50-1F.b. to disclose the "basis for the entity's defense or a statement that the entity has not yet formulated its defense" may suggest that the disclosure is required even though the defense has not yet been disclosed in court filings or other public documents or to the plaintiff. Premature disclosure regarding a company's defense strategy could be prejudicial to the defense and could adversely affect a company's ability to properly manage the litigation. We

recommend that this requirement be revised to require disclosure of information about the company's defense to the litigation only to the extent that information is publicly available. At the very least, that information should not be required before it has actually been disclosed to the plaintiff.

Relevance of External Studies. Proposed paragraph 450-20-55-14 adds subparagraph d., which identifies studies in scientific journals and other credible sources that indicate potential hazards related to a company's products or operations as an example of information a company should consider in determining the probability that a claim will be asserted and the likelihood of an unfavorable outcome. We understand that example to be illustrative and not to deprive a company of the ability to exercise judgment as to the relevance and credibility of such information. However, we are concerned that singling out this specific type of information will give it undue weight and prevent companies from being able to exercise the appropriate judgment. In addition, this example might be interpreted as requiring companies to identify and become familiar with, and assess the accuracy of, studies in scientific journals, which would impose an unjustified burden on companies. The relevance and credibility of external studies can vary widely, are subject to change and are often contradictory. They are just one item of information a company may have to consider, depending on the circumstances, but they should not be singled out and given undue weight. Thus, we urge deletion of new subparagraph d.

Materiality of Disclosure. The ABA recommends that proposed paragraph 450-20-50-1F be revised to make clear that no disclosure is required about individually immaterial loss contingencies unless they are material on an aggregate basis. Although a materiality assessment is suggested by proposed paragraphs 450-20-50-1E and BC21, we believe this clarification is appropriate in proposed paragraph 450-20-50-1F. We believe that revising the first sentence of paragraph 450-20-50-1F as follows would appropriately clarify the disclosure requirement: "An entity shall disclose the following about individually material loss contingencies (or classes (types) of similar contingencies) and loss contingencies (or classes (types) of similar contingencies) that are material in the aggregate, if such loss contingencies meet the disclosure threshold described in paragraphs 450-20-50-1C through 50-1E."

Effect on ABA Statement

The ABA agrees that auditability is a relevant consideration for assessing the changes in accounting standards proposed by the Revised Exposure Draft. In that connection, we note the Board's statement that it will continue to work with the ABA, the PCAOB and the AICPA to identify and address any potential implications of the proposed changes for the ABA Statement and related U.S. auditing standards. For the reasons explained below, we do not at this time believe that the revisions proposed in the Revised Exposure Draft, as we understand them, or as they may be revised to reflect our recommendations, would require any changes to the ABA Statement as such, although steps can be taken as described below to provide guidance to lawyers regarding the effect of any revision of ASC Subtopic 450-20. The ABA, of course, would be happy to participate in discussions should that be helpful.

In our view, the ABA Statement has stood the test of time and has been successful in achieving its purposes. These purposes include providing information to auditors regarding specified loss contingencies and allowing auditors to rely upon counsel having fulfilled their professional responsibility to advise the client, when appropriate in connection with counsel's

engagement, regarding the client's disclosure obligation, while, at the same time, maintaining client confidences and ensuring preservation of the fundamental protections of the attorney-client privilege and the work product doctrine. The ABA Statement was carefully designed through an understanding between the legal profession and the accounting profession to strike the appropriate delicate balance. The purposes underlying the ABA Statement are as important now, and perhaps even more important, than they were when the ABA Statement was approved over 30 years ago.

We do not believe that the information requirements of the Revised Exposure Draft, both quantitative and qualitative, require changes to the ABA Statement. The ABA Statement does not detail the information a lawyer is to provide an auditor regarding claims and therefore no change is necessary to reflect any enhanced disclosure requirements.

We also have considered whether the proposed change to the disclosure threshold to require disclosure of asserted claims that are remote but may have a potentially severe impact would require a change in the ABA Statement. Although, as discussed above, we do not favor such change to the disclosure threshold, if the change were to be adopted, we do not believe a change in the ABA Statement would be necessary. The ABA Statement contemplates that counsel, when requested by the client, will identify all material asserted claims to which counsel has devoted substantive attention without regard to their likely outcome, and thus a change in the threshold for disclosure of asserted claims would not affect audit responses under the ABA Statement. Moreover, the potentially severe impact of a matter is not a legal determination for counsel to make but rather, like the probability of the assertion of an unasserted claim, is a determination for the client to make. Similar to counsel having the professional responsibility to advise counsel's client regarding disclosure of unasserted claims, counsel has the professional responsibility to advise the client regarding disclosure of asserted claims when that is within the scope of his or her engagement. Paragraph 6 of the ABA Statement makes clear that this professional responsibility applies generally.

We expect that, if necessary and to the extent appropriate, the ABA Business Law Section's Committee on Audit Responses will issue a statement reflecting the foregoing. In that event, we expect that, if the FASB were to change the disclosure threshold, such statement from the Committee would make clear that a lawyer would need to take that change into account in advising the client, to the extent within the scope of the lawyer's engagement, regarding the client's disclosure obligation with respect to asserted remote claims. We also expect such a statement would alert lawyers to the additional information requirements resulting from a revision of ASC Subtopic 450-20 that should be considered by a lawyer in responding to an auditor in accordance with the existing ABA Statement. See the Committee's "Statement on Effect on FIN 48 on Audit Response Letters," 64 Bus. Law. 389 (2009), for a similar statement on the effect of a change in accounting standards for tax contingencies on audit responses.

Request for Deferral of Effective Date

The Exposure Draft provides that, for public companies, the new guidance will be effective for fiscal years ending after December 15, 2010, and for interim and annual periods in subsequent fiscal years. Compliance with the proposed effective date would be extremely burdensome, particularly if, notwithstanding our comments on the Revised Exposure Draft, the requirements are adopted substantially as proposed.

In view of the breadth of the disclosure requirements in the Exposure Draft as compared to the current standard, companies will have to dedicate substantial resources to collect relevant information and consider disclosure obligations under the new guidance. The need to prepare an inventory of all pending litigation, with the requisite case-specific information for all material contingencies, to assess the appropriate extent of permissible aggregation of loss contingencies and prepare a description of the bases for such aggregation, and to prepare the qualitative and quantitative disclosures, including the description of the bases for the claims and any defenses, would take a considerable amount of time and deliberation. Moreover, the inevitable implementation questions that arise with the application of a significant new standard, coupled with what is certain to be the sensitive nature of some loss contingency disclosures, including the need to consider the impact of such disclosures on the attorney-client privilege and work product protections, militate in favor of providing public companies sufficient time to permit them to make disclosure decisions with care.

In addition, public companies will need time to modify their internal control systems and disclosure controls and procedures to ensure that these controls and procedures are effective in providing timely, relevant and reliable information to company management in order to comply with the new disclosures. Extending the adoption schedule for the new guidance also would benefit audit committees, management and auditors by providing a reasonable time frame for these parties to engage in an informed dialogue about the guidance and to evaluate expectations in relation to the disclosure requirements. Once disclosures are prepared, audit committees likely will want to discuss the narrative descriptions with management and satisfy themselves that such descriptions, particularly the descriptions of the bases for the claims and the companies' defenses, are accurate and consistent with the FASB's requirements and do not adversely affect shareholders' interests. There will simply not be enough time for calendar year companies to do this by the proposed effective date.

To allow public companies adequate time to implement the final guidance, the ABA encourages the FASB to change the proposed effective date so that it is effective for public companies for fiscal years ending after December 15, 2011, and then for interim and annual periods, as applicable, in subsequent fiscal years. A similar one-year deferral should be made for private companies so that they can benefit from the experience of public companies and have additional time to deal with the revised requirements.

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The ABA appreciates the opportunity to comment on the Revised Exposure Draft and is available to discuss these comments should the FASB or its staff so desire.