

FASB Begins Redeliberations on Disclosure of Certain Loss Contingencies Project

September 25, 2009

At its meeting on August 19, 2009, the Financial Accounting Standards Board began redeliberations on the proposed amendments to disclosure requirements applicable to certain loss contingencies contained in Statement of Financial Accounting Standards No. 5, Accounting for Contingencies ("FAS 5") (now FASB Accounting Standards Codification Subtopic 450-20). In its redeliberations, the FASB decided to focus initially on disclosure of litigation loss contingencies, with other types of loss contingencies to be considered at future meetings.

The FASB discussed:

- the effective date of the proposed amendments
- the objective of the required disclosure
- the principles by which the disclosure should be governed
- the appropriate thresholds for disclosure
- the appropriate approach to quantitative disclosure requirements
- disclosure about settlement negotiations and
- disclosure about insurance and indemnification arrangements.

In June 2008, the FASB had issued an Exposure Draft of proposed amendments to FAS 5 and Statement of Financial Accounting Standards No. 141(R), Business Combinations (now FASB Accounting Standards Codification Topic 805).¹ In September 2008, the FASB delayed the proposed effective date by one year to no sooner than for fiscal years ending after December 15, 2009. The FASB staff also conducted a limited field test of an alternative model² to address concerns raised in comments on the Exposure Draft, and two public roundtable discussions were held in March 2009 on the proposed amendments. Dewey & LeBoeuf was one of three law firms invited to participate in the roundtable discussions.

¹ The Exposure Draft of proposed amendments to FAS 5 is available [here](#), and our Client Alert of July 23, 2008 entitled "Upcoming Deadlines for Proposed Amendments to SFAS No. 5 Accounting for Loss Contingencies" is available [here](#).

² For more information about the alternative model, see our Client Alert of March 13, 2009 entitled "FASB Holds Roundtable Discussion on Disclosure of Certain Loss Contingencies," available [here](#).

Effective Date

While the FASB did not rule out the possibility that the proposed amendments could become effective for fiscal years ending after December 15, 2009, certain FASB members questioned whether that effective date is realistic in light of the ongoing redeliberations. The FASB staff had recommended a one-year delay.

Disclosure Objective

The FASB agreed on the following objective for disclosure about litigation loss contingencies:

An entity shall disclose qualitative and quantitative information about the loss contingency to enable a financial statement user to understand the nature of the contingency and its potential timing and magnitude.

This disclosure objective differs from the objective included in the Exposure Draft³ and is based on the approach followed by the alternative model. However, it also differs from that approach in that:

- it does not specifically limit disclosable information to factual information, although the FASB acknowledged during the meeting that no disclosure should be required of information that is predictive in nature and
- it requires disclosure with respect to the timing of the contingency's outcome, which the alternative model did not require.

Principles of Disclosure

The FASB decided that disclosure about litigation loss contingencies should be governed by the following three broad principles, on which there had been consensus at the roundtable discussions.

Focus on contentions

Disclosure about litigation contingencies should focus on the contentions of the parties, rather than predictions about the future outcome. The FASB agreed that companies should not be required to disclose any information that may be prejudicial to ongoing litigation, such as predictions as to the outcome.

³ The Exposure Draft would have required "[a]n entity [to] provide disclosures to assist users of financial statements in assessing the likelihood, timing, and amount of future cash flows associated with loss contingencies that are (or would be) recognized as liabilities in a statement of financial position," including information about the risks associated with those loss contingencies and their potential and actual effects on the company's financial position, cash flows and results of operations.

Provide more robust information as litigation progresses toward resolution

The scope of required disclosure may vary depending on the stage of pending litigation and the likelihood and magnitude of any loss. Generally, the amount of information required to be disclosed about pending litigation would increase as the litigation progresses toward resolution, and the disclosure should become more robust as the likelihood and magnitude of a potential loss increase.

Provide a summary of publicly available information and how to obtain more information

Disclosure should summarize publicly available information about a case and include additional details, such as court venues and docket numbers, so that readers may obtain more information if they wish to do so. The FASB clarified that companies would not be required to include hyperlinks to court dockets in their disclosure to address auditors' concerns about verifying information on hyperlinked websites. It also agreed that companies could not simply state that additional information is available upon request.

The FASB agreed that these three broad principles should be explicitly stated in the amended standard. It also considered, but did not adopt, a fourth principle to the effect that disclosing the contingency should not affect its outcome, because it determined that this concept was already included in the first principle.

Threshold for Disclosure

Asserted claims and assessments

The FASB agreed to maintain the current threshold that calls for disclosure about asserted claims and assessments where the likelihood of loss is at least reasonably possible.⁴

The FASB also agreed that a company should be required to disclose certain remote loss contingencies – for example, those that could have a severe or catastrophic effect on the company – and directed the FASB staff to develop possible approaches for discussion at a future meeting.

In addition, the FASB decided to include interpretive guidance in the amended standard clarifying that decisions to disclose a contingency should be based on the total mix of available information. For example, disclosure of a frivolous claim is not automatically material because it involves a very large claim amount.

⁴ As a general rule, the Exposure Draft would have required disclosure about asserted claims and assessments unless the likelihood of loss was remote. However, the Exposure Draft would also have required disclosure about remote loss contingencies if the contingency was expected to be resolved in the near term and the contingency could have a severe impact on the company's financial position, cash flows or results of operations.

Unasserted claims and assessments

The FASB decided not to change the current standard requiring disclosure about unasserted claims and assessments where the likelihood of loss is at least reasonably possible and assertion of the claim is probable.⁵

The FASB also determined to supplement existing interpretive guidance⁶ on the treatment of unasserted claims and assessments by:

- clarifying that a company should consider all information available when determining the degree of probability that a claim will be asserted and an unfavorable outcome could occur and
- adding "the existence of peer-reviewed studies in reputable scientific journals that indicate potential hazards related to the entity's products and aspects of its operations" to the other examples of when assertion of a claim may be probable and when an unfavorable outcome is possible.

Effect of insurance and indemnification arrangements

The FASB decided that companies should not consider the possibility of recoveries from insurance or indemnification arrangements when assessing whether a contingency needs to be disclosed.

Quantitative Disclosure

The FASB directed the staff to develop, for consideration at a future meeting, an approach that focuses on disclosure of non-privileged quantitative information relevant to estimating the potential loss. The Exposure Draft would have required disclosure of either the claim amount or, if there was no claim amount, the company's best estimate of the maximum exposure to loss.

Settlement Negotiations

The FASB decided not to require disclosure about settlement negotiations because such disclosure may affect the negotiations and the potential outcome of the matter.

However, a company would need to consider such negotiations when determining how much information it needs to disclose about a contingency. Certain members of the FASB expressed the view that settlement negotiations may indicate that an unfavorable outcome is

⁵ Except for the expanded duty to disclose certain remote loss contingencies described in footnote 4, for unasserted claims and assessments, the Exposure Draft would have required disclosure about a contingency where it was probable that a claim would be asserted and the likelihood of loss was more than remote.

⁶ Paragraph 38 of FAS 5 (now FASB Accounting Standards Codification paragraph 450-20-55-14).

more likely and that, therefore, more detailed disclosure about the contingency should be required at that stage.

Insurance and Indemnification Arrangements

The FASB decided to require disclosure about possible recovery from insurance and other arrangements only to the extent that such information was provided to plaintiffs in discovery.⁷ This disclosure would be limited to factual information. In addition, companies would have to disclose whether any insurance coverage was subject to dispute with the carrier and the facts relating to that dispute.

Next Steps

The FASB expects to continue redeliberations in the fall. We expect that the FASB at that time will consider further the potential effective date for any amendments. According to the FASB's Current Technical Plan and Project Updates, the FASB intends to release the amended standard during the fourth quarter of 2009.

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⁷ The Exposure Draft would have required disclosure about the terms of insurance or indemnification arrangements, regardless of whether the information had been provided to plaintiffs in discovery. This disclosure would have included information on caps, limitations and deductibles that could affect the amount of recovery. During the roundtable discussions, attorneys commented that plaintiffs might seek additional damages if this type of information were disclosed.