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FASB Proposes Expanded Disclosure Requirements for Loss Contingencies Relating to Liabilities

On June 5, 2008, the Financial Accounting Standards Board (“FASB”) issued an Exposure Draft pursuant to which it proposed expanding the disclosure requirements for certain loss contingencies within the scope of FASB Statement No. 5, *Accounting for Contingencies* (“FASB No. 5”) and FASB Statement No. 141 (revised 2007), *Business Combinations* (“FASB No. 141(R)”)¹. If adopted, the proposed amendments, which would apply only to loss contingencies that are or would be recognized as liabilities in a statement of financial position and for other contingencies that meet the criteria for loss contingencies, such as liabilities relating to pending or threatened litigation², would likely:

- significantly expand both the number of loss contingencies that will need to

be disclosed by creating a presumption in favor of disclosure of *all* loss contingencies; and

- drastically increase the level of required quantitative and qualitative detail for disclosable loss contingencies.

A number of industry participants, including the American Bar Association, fear that the amendments, if adopted, will have wide-reaching and potentially severe negative consequences on public company issuers with litigation matters. Over 225 comment letters were submitted to the FASB during the comment period for the Exposure Draft, which ended on August 8, 2008. Expressed concerns include, among other things, potential threats to the attorney-client privilege and work-product immunity doctrine, increased tension involving the auditor-client relationship, the potential forced disclosure of litigation strategy which can be used by adversarial parties to the issuer’s disadvantage in litigation and undue investor confusion and concern.

Certain of the key changes introduced in the Exposure Draft are briefly discussed below. This summary, however, is not exhaustive and we recommend you closely review the full text of the Exposure Draft and contact your Hunton & Williams

¹ The current version of FASB No. 5 (which has not been amended since enacted in 1975) is available at <http://www.fasb.org/pdf/fas5.pdf>. The current version of FASB No. 141(R) (revised in 2007) is available at <http://www.fasb.org/pdf/fas141r.pdf>.

² The proposed amendment would not apply to, among others, (i) loss contingencies that are or would be recognized as asset impairments, such as allowances for uncollectible accounts receivable and impairments of loans, (ii) guarantees, (iii) liabilities for insurance-related assessments and (iv) liabilities for employment related costs, such as pensions and other post employment benefits. The proposed amendment also would not change the recognition and measurement guidance for loss contingencies.

attorney if we can be of assistance regarding these important developments.

Expansion of the Number of Disclosable Loss Contingencies

Under the current FASB No. 5 standard, the financial statement impact and financial note disclosure requirements for loss contingencies depend on the likelihood of occurrence of the applicable loss contingency. An issuer must classify each loss contingency as either (i) probable (the likelihood of occurrence is likely), (ii) reasonably possible (the likelihood of occurrence is more than remote but less than likely) and (iii) remote (the likelihood of occurrence is slight). Once so classified:

- If the loss is probable and the amount of loss can be reasonably estimated — the issuer must accrue for the liability in its financial statements;
- If the loss is probable but the amount of loss cannot be reasonably estimated or if the loss is reasonably possible — accrual is not generally required but the issuer must disclose certain information regarding the loss contingency in the financial notes, including the nature of the contingency and an estimate of the possible loss or range of loss, or a statement that such an estimate cannot be made; and
- If the loss is remote — accrual or disclosure is not generally required.

In issuing the Exposure Draft, the FASB expressed its concern that the “reasonable possibility” standard has not produced sufficient disclosure of loss contingencies. Accordingly, the proposed amendments would require

disclosure of *all* loss contingencies, unless (i) the issuer affirmatively determines that the likelihood of loss is remote or (ii) the potential claimant has not manifested an awareness of a possible claim or assessment, unless it is probable the claim will be asserted and the likelihood of loss, if the claim or assessment is asserted, is more than remote.

Even if the likelihood of loss is assessed by the issuer to be remote, financial note disclosure will still be required if the loss contingency, or a combination of loss contingencies, is expected to be resolved within a year of the date of the financial statements and could have a “severe impact” on the issuer’s financial position, cash flows or results of operations.

Expansion of the Level of Required Qualitative and Quantitative Disclosure

As illustrated on page 4, the proposed amendments would require expanded qualitative and quantitative disclosure regarding loss contingencies that are, or would be, recognized under FASB No. 5 and in a business combination under FASB No. 141(R).

Currently, if a loss is reasonably possible, an entity must disclose the nature of the contingency accrual and the amount accrued or, if no accrual is made, the nature of the contingency and an estimate of the loss or a statement that an estimate cannot be made.

Under the proposed amendments, the following expanded and qualitative disclosures would be required for disclosable loss contingencies:

- the amount of damages claimed or, if no amount of damages is claimed,

an estimate of the maximum loss exposure (the best estimate of the loss may be provided supplementally if the amount of claim or maximum exposure is not representative of actual exposure);

- a description of the contingency, including how it arose, its legal or contractual basis, its current status and the anticipated timing of its resolution;
- the factors that are likely to affect the ultimate outcome of the contingency, together with their potential effect on the outcome;
- an assessment of the most likely outcome of the contingency;
- any assumptions made to estimate the amounts in the quantitative disclosures and to assess the most likely outcome; and
- a detailed description of any related insurance, indemnification or similar arrangements that could lead to recovery of some or all of the loss contingency.

Under the proposed amendments, issuers may, in certain circumstances, aggregate any qualitative or quantitative information according to the nature of the loss contingency (i.e., product liability, securities violations, etc.).

These expanded disclosures may have a significant adverse impact on an issuer’s ability to administer its litigation strategy, including by forcing public disclosure of information one would ordinarily seek to keep confidential during the pendency of a litigation. Internal information as to litigation strategy, loss estimates, availability of insurance, etc. could, and likely would, be used to

the detriment of the issuer by litigation adversaries.

Tabular Reconciliation of Loss Contingencies

The proposed amendment would require a reconciliation, in tabular format, of the aggregate amount recognized for loss contingency accruals in annual and interim financial statements, showing loss contingencies accounted for under FASB No. 5 separate from loss contingencies accounting for under FASB No. 141(R). The reconciliation must include, at a minimum, the following:

- increases for loss contingencies recognized during the period;
- increase resulting from changes in estimates of the amounts of loss contingencies previously recognized;
- decreases resulting from changes in estimates or de-recognition of loss contingencies previously recognized; and
- decreases resulting from cash payments (or other forms of settlement) for loss contingencies.

Additionally, an entity is required to provide a qualitative description of the significant activity in the reconciliation and disclose the line items in its statement of financial position in which

recognized loss contingencies are included. An entity must also disclose the total recoveries from insurance, indemnification or similar arrangements that are recognized in each statement of financial position and statement of income presented and that are related to loss contingencies included in the reconciliation.

However, to alleviate concerns that information regarding specifically identified loss contingencies could be used in legal disputes, the amounts recognized for all loss contingencies may be aggregated in the reconciliation. In addition, loss contingencies whose underlying cause and ultimate settlement occur in the same period may be excluded from the reconciliation.

Disclosure Exemption for Prejudicial Information

Noting that disclosure of certain contingencies, such as pending or threatened litigation, may be prejudicial to an entity's position, the FASB included in the proposed amendment a limited exemption that would allow an entity to aggregate the disclosures regarding loss contingencies at a higher level than by the nature of the contingency. In instances in which aggregated disclosure at a higher level would still be prejudicial (which the FASB considers "rare"), an entity would be allowed to

forgo disclosing only the information that would be prejudicial to the entity's position. However, in no circumstances, may an entity forgo disclosing the amount of the claim or assessment against the entity (or an estimate of the maximum exposure to loss), providing a description of the loss contingency and providing a description of the factors likely to impact the ultimate outcome of the assessment.

Proposed Effective Date

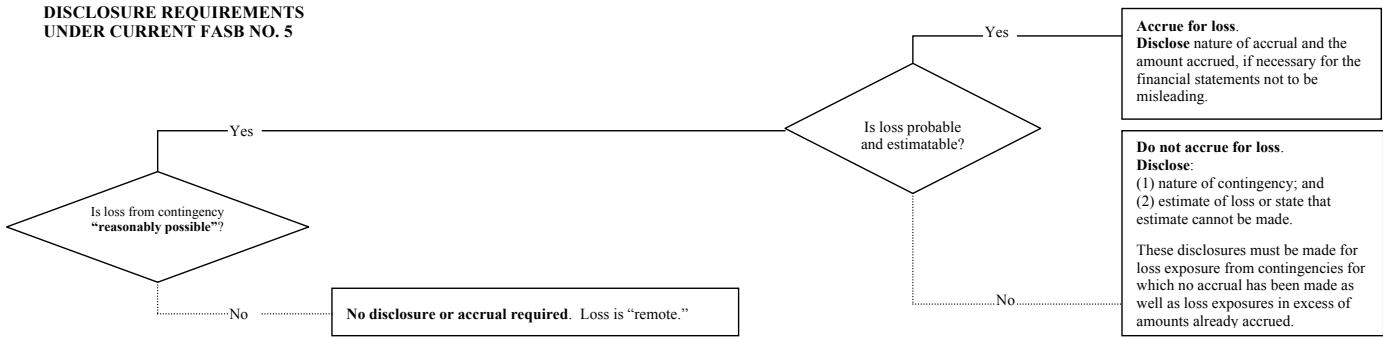
The amendments, as proposed, were to have been effective for fiscal years ending after December 15, 2008 and interim and annual periods in subsequent fiscal years. On September 24, 2008, the FASB announced its intentions to re-deliberate the proposed amendments based upon, among other things, the concerns expressed in the comment letters. These actions are expected to delay the issuance of any amendments until sometime in 2009.

The complete text of the proposed amendment is available from the FASB at <http://www.fasb.org/draft/index.shtml>.

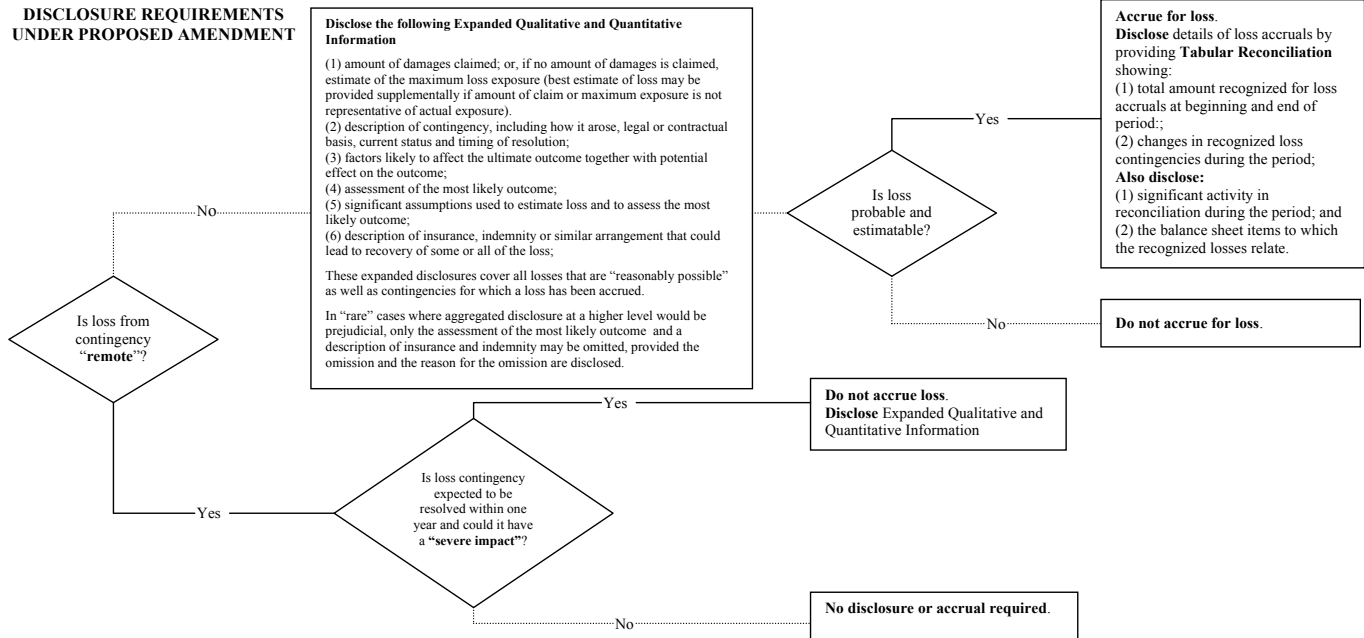
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If you have any questions or would like additional information regarding FASB's proposed amendment, please contact your Hunton & Williams.

**DISCLOSURE REQUIREMENTS
UNDER CURRENT FASB NO. 5**



**DISCLOSURE REQUIREMENTS
UNDER PROPOSED AMENDMENT**



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