

FASB Abandons Project to Modify Contingency Disclosure Requirements

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On July 9, 2012, the Financial Accounting Standards Board determined to remove from its agenda its project to modify accounting standards related to disclosure of loss contingencies, including litigation. This project was first added to the FASB's agenda in 2007. Since that time, two Exposure Drafts have been released (the first in June 2008 and the second in July 2010) of a proposed Accounting Standards Update to Topic 450 – Contingencies.

The FASB staff noted in materials for the July 9 meeting that the feedback received on both Exposure Drafts was similar. "There was overwhelming opposition to the enhanced loss contingency disclosures," with concerns that the proposed requirements could be prejudicial to the reporting entity's stance in the subject litigation. Such requirements included possible disclosure of "remote" litigation contingencies; a requirement in certain cases to disclose the amount claimed by plaintiff or the amount of damages indicated by the testimony of expert witnesses; a requirement to disclose an estimate of the "possible" loss or range of loss; a requirement to disclose the amount that has been accrued for particular litigation matters or by class; a requirement to explain why an estimate of loss could not be made, if none was made; and a requirement of a tabular reconciliation, by class, of accrued loss contingencies, explaining changes by period.

The FASB decision means that for the foreseeable future, companies will continue to operate under the terms of existing Accounting Standard Compilation 450 (previously FASB No. 5). Under such terms, **accrual** of a loss contingency is required if it is "probable" that a liability has been incurred, **and** that the amount of loss can be reasonably estimated. "Probable" is defined as "likely to occur." Ordinarily, the accrual will be reflected in the financial statements without specific identification that a particular accrual amount has been recorded for a particular litigation matter. However, disclosure of the amount accrued may "in some circumstances" be necessary in order for the financial statements not to be misleading. The standard contains no further guidance as to what such circumstances may be.

Disclosure of a loss contingency is required (typically in a contingencies footnote) if there is at least a "reasonable possibility" of a loss, and an accrual is not made because the requirements for accrual have not been met. "Reasonable possibility" means more likely than "remote," but less likely than "probable." The disclosure must include both 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.

There has been an increased focus by the SEC upon litigation contingency disclosures under these existing requirements during the course of the FASB's consideration of its project. The

staff has indicated that it is concerned about situations where the disclosure of a loss contingency does not include an estimate of possible loss or range of loss, and that it may ask companies to provide support for an assertion that such an estimate cannot be made. The Chief Accountant of the Division of Corporation Finance has stated publicly that required estimates may not be omitted because the possible loss or range of loss cannot be determined “with precision and confidence.” In addition, in the staff’s view, asserting that an estimate of the possible loss or range of loss cannot be made will be more difficult as litigation progresses.

The staff has indicated that where a large settlement of litigation occurs with little or no disclosure in prior periods, it will scrutinize the prior period disclosure as to compliance with Topic 450.

An important concern of companies in this area is that particularized public disclosure as to estimated loss or range of loss in a given litigation matter where loss is reasonably possible could jeopardize the company’s posture in the matter, making it difficult to resolve the matter for any amount less than the disclosed estimate. Some companies have responded to this concern by disclosing estimated losses in the aggregate for cases where an estimate can be provided, without identifying which particular litigation matters are those to which the estimate relates.

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