JONES DAY

JUNE 2010

FASB DELIBERATIONS RETURN TO LITIGATION CONTINGENCY DISCLOSURES

The Financial Accounting Standards Board (the "Board") has returned to public deliberations on the sensitive subject of disclosures for litigation loss contingencies under Financial Accounting Standard ("FAS") 5.[1] On April 14, 2010, the Board continued its redeliberations following the sharply negative comments to its 2008 Exposure Draft[2] that would have called for significantly increased disclosures associated with litigation. In the latest deliberations, the Board tentatively agreed on a number of disclosure requirements that will be contained in a new exposure draft. The Board also agreed to promulgate the new exposure draft during the second quarter of this year and to allow a 30-day comment period on the new draft. Importantly, the new guidance, once finally adopted, will be effective for public reporting companies for fiscal years ending after December 15, 2010.[3]

The tentative decisions reached during the redeliberations are not yet final. Many of the agreed positions represent significant retrenchment from the proposed disclosure requirements set forth in the 2008 Exposure Draft. This is particularly true with respect to disclosure of information that many of the 2008 commenters believed would infringe on the attorney-client privilege. The tentatively agreed additional disclosures, however, are still likely to require significant additional quantitative and qualitative information depending on the stage of the underlying litigation, as well as tabular information regarding accrued litigation loss contingencies.

1 FAS 5 is now known under the FASB's Accounting Standards Codification system as ASC 450-20.

2 FASB, Exposure Draft: Proposed Statement of Financial Accounting Standards, Disclosure of Certain Loss Contingencies (June 5, 2008), available at http://www.fasb.org/ed_contingencies.pdf.

3 For nonpublic entities, the new guidance will be effective for the first annual period following December 15, 2010.

WHEN TO ACCRUE FOR A LITIGATION LOSS CONTINGENCY: NO CHANGE

FAS 5 currently requires an entity to accrue for a loss contingency when the loss is (1) probable and (2) the amount of the loss is reasonably estimable.[4] Neither the 2008 Exposure Draft nor the redeliberations contemplate any change to this requirement.

WHEN TO DISCLOSE LITIGATION LOSS CONTINGENCIES; DISCLOSURE OF "REMOTE" CONTINGENCIES

During the redeliberations, the Board agreed to keep in place the current disclosure requirement for asserted claims "whose likelihood of loss is at least reasonably possible."[5] The 2008 Exposure Draft included an additional requirement to disclose certain loss contingencies with a potentially severe impact in the near term (*i.e.*, within a year) even if the likelihood of loss is remote. In its April 2010 meeting, the Board reaffirmed its position that disclosure of remote contingencies should also be determined based on "their nature, potential timing or potential magnitude," but left it to the entity's judgment to determine when disclosure is required.[6] The Board suggested that factors to be considered by the entity might include the plaintiff's damage claim against the entity (although the Board indicated that this factor may not be dispositive), the potential impact on operations, the cost of defense, and the effort and resources of management required to resolve the contingency.[7]

4 FASB, Statement of Financial Accounting Standards No. 5 ¶ 8 (Mar. 1975), available at http://www.fasb.org/pdf/fas5.pdf.

5 FASB, *Minutes of the April 14, 2010 Board Meeting: Disclosures on Loss Contingencies* ¶ 3 (Apr. 14, 2010), *available at* http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176156809218.

6 *Id.* ¶ 3.

7 *Id.* ¶¶ 3-4.

ADDED QUANTITATIVE DISCLOSURES RELATING TO ANY CONTINGENCY THAT IS "AT LEAST REASONABLY POSSIBLE" AS WELL AS FOR "REMOTE" CONTINGENCIES THAT MEET THE DISCLOSURE THRESHOLD

Through its redeliberations, the Board has tentatively concluded that, "for all contingencies that are at least reasonably possible," the entity should disclose quantitative information regarding the potential loss, including the following: publicly available information regarding the plaintiff's damage claim or expert testimony about the amount of damages; an estimate of the possible range of loss and amount accrued or, if not estimable, a statement that the range cannot be estimated and the reason; and other nonprivileged information that would assist financial statement users "to understand and/or assess the possible loss."[8] If information regarding possible insurance or other recovery is discoverable or relates to a recognized receivable for the loss, that information would also need to be disclosed, as well as the fact that an insurer has denied or contests coverage.[9]

The Board has indicated that, for disclosed remote contingencies, the entity should provide the same level of quantitative disclosure, except that an estimate of the possible range of loss or a statement regarding the inability to estimate such a range need not be included.[10]

ADDED QUALITATIVE DISCLOSURES AS LITIGATION PROGRESSES AND FOR INDIVIDUALLY MATERIAL LITIGATION CONTINGENCIES

The Board tentatively decided that, for any disclosed contingency, the entity would be required to disclose "[q]ualitative information to enable users to understand the nature

8 *Id.* ¶ 7. When a plaintiff has not stated a specific damage amount, the 2008 Exposure Draft required an entity to disclose the entity's "best estimate of the maximum exposure" and eliminated the exemption permitting an entity to explain that the maximum exposure was not estimable. 2008 Exposure Draft, *supra* note 2, ¶ 7(a), app. A16.

9 April 14, 2010 Board Minutes, *supra* note 5, ¶ 7(e).

10 *Id.* ¶ 8.

and risks of a contingency or group of contingencies."[11] At an early stage of litigation, that disclosure would include at least the contentions of the parties. As additional information becomes available through the course of the litigation, the disclosure should be expanded.[12]

The Board appears to have retreated from the 2008 Exposure Draft requirement that an entity should describe the factors likely to affect the resolution of the contingency, the "most likely outcome" of the contingency, and the assumptions underlying the entity's assessments of the most likely outcome and the maximum loss or range of possible loss.[13]

With respect to an individually material litigation contingency, the entity would be required to describe the proceedings, the allegations, and the procedural status with enough specificity to permit users to identify and pursue any available public information regarding the litigation from court files.[14] Also, "if practicable," the entity would be required to disclose information regarding "the anticipated timing of, or the next steps in, the resolution" of the material contingency.[15]

For aggregated disclosures, the entity would be required to provide the basis for aggregation and information that would enable users to understand "the nature, potential timing, and potential magnitude of loss."[16]

The 2008 Exposure Draft would have provided a limited exemption for disclosure of certain categories of otherwise required qualitative information if disclosure would prejudice the entity's position with respect to that litigation.[17] That exemption, however, is not discussed in the summary of the Board's April 14, 2010 redeliberations.

11 *Id.* ¶ 6(a).

12 *Id.* ¶ 6(b).

13 2008 Exposure Draft, *supra* note 2, ¶ 7(b), app. A18.

14 April 14, 2010 Board Minutes, *supra* note 5, ¶ 6(c).

15 *Id.* ¶ 6(b).

16 *Id.* ¶ 6(d).

17 2008 Exposure Draft, *supra* note 2, ¶ 11.

ADDED TABULAR RECONCILIATION OF ACCRUED LITIGATION LOSS CONTINGENCIES

Both the 2008 Exposure Draft and the April 14, 2010 redeliberations reflect a requirement to provide, in tabular format, a reconciliation by class of activity in the entity's accrued loss contingencies between the beginning and ending date of the reporting period.[18] In its redeliberations, the Board determined that this requirement should not apply to nonpublic entities.[19]

CONCLUSION

While the revised exposure draft is not yet available, the comment period will be brief. The Board has stated that the new standard will be effective for financial statements covering 2010. Issuers, therefore, should prepare for revised disclosures, and public companies with significant accrued loss contingencies should carefully consider expected "tabular reconciliation" disclosures.

LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

Michael L. Davitt
Dallas
+1.214.969.2938
mldavitt@jonesday.com

Jeanne M. Rickert
Cleveland
+1.216.586.7220
jmrickert@jonesday.com

Henry Klehm III
New York
+1.212.326.3706
hklehm@jonesday.com

Patricia J. Villareal
Dallas
+1.214.969.2973
pjvillareal@jonesday.com

18 2008 Exposure Draft, *supra* note 2, ¶¶ 8-9; April 14, 2010 Board Minutes, *supra* note 5, ¶¶ 9-10.

19 April 14, 2010 Board Minutes, *supra* note 5, ¶ 11.