CLIENT ALERTS & INSIGHTS

Litigation Contingency Disclosure: An Area of Increased SEC Scrutiny

MAY 1, 2011

Authors: Megan L. Mehalko

The SEC has recently increased its scrutiny of litigation contingency disclosures for compliance with financial statement disclosure rules. In recent comment letters, the SEC has questioned the adequacy of litigation contingency disclosures, and the Chief Accountant of the SEC's Division of Corporation Finance has also mentioned this topic in recent speeches. This increased SEC focus comes at the same time that the Financial Accounting Standards Board ("FASB") is reviewing comments on an exposure draft of an accounting standards update that would require companies to provide additional disclosure on litigation contingencies.

ASC Topic 450 provides that a company must accrue a loss contingency if information available before the financial statements are issued indicates that it is probable that a liability has been incurred as of the date of the financial statements and the amount of loss can be reasonably estimated. Disclosure of the contingency must be made if there is at least a reasonable possibility that a loss or an additional loss may have been incurred and either (1) an accrual is not made for a loss contingency because information indicating that a liability has been incurred is not available before the financial statements are issued or the amount cannot be reasonably estimated or (2) an exposure to loss exists in excess of the amount accrued.

The SEC and FASB are both paying increased attention to this topic as they realize that the transparency in financial reporting is at odds with the adversarial system of justice. FASB wants financial statement users to get the best possible information that financial statements can convey, but a company can be seriously damaged if it is too transparent in the area of litigation contingencies. A company may be afraid of providing information that could be very helpful to a plaintiff and its attorneys in developing litigation strategy. To alleviate this, the Chief Accountant has stated that a "reasonably possible" range of loss may be stated in the aggregate, which may make it harder for a plaintiff to discover the company's assessment of exposure in a particular litigation case. This may be the only case where a company is advantaged if it has a lot of litigation!! The Chief Accountant has also stated that a disclosure may provide that an estimate cannot be made "with certainty" or "with confidence" and therefore no estimate is provided. While this is helpful, the SEC may question a company's disclosure practices if a company discloses a settlement after it has failed to provide litigation contingency estimates.

To enhance disclosure, FASB issued an exposure draft of an accounting standards update in 2010 that would require companies to disclose the amount accrued, if any, in connection with a litigation contingency. This would include a tabular reconciliation of the beginning and ending accrual balance. FASB is in the process of working through the more than 380 comment letters it received

on that exposure draft. FASB is not expected to meet again on the matter until the second half of 2011 but it is expected that FASB will likely move quickly to implement whatever decision it makes.

We will continue to watch the SEC's scrutiny and FASB's conclusions on enhanced disclosure requirements and will provide updated guidance as major developments occur.

For more information or if you have questions regarding this topic, please contact:

Megan L. Mehalko at (216) 363-4487 or mmehalko@beneschlaw.com