



**fei**<sup>SM</sup>

financial executives  
international

August 8, 2008

Technical Director  
File Reference No. 1600-100  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

Re: File No. 1600-100, Disclosure of Certain Loss Contingencies - an amendment of FASB Statements No.5 and 141(R)

Dear Technical Director:

Financial Executives International appreciates the opportunity to share its views on the proposed Statement of Financial Accounting Standards – “Disclosure of Certain Loss Contingencies – an amendment of FASB Statements No. 5 and 141(R).”

FEI responds to such requests through its technical committees. As a result, I have attached letters from the following committees in response to the proposed rule:

- A joint letter of FEI’s Committees on Corporate Reporting (CCR) and Government Business (CGB)
- FEI’s Committee on Private Companies (CPC)

Thank you again for the opportunity to provide our comments.

Sincerely,

Christine DiFabio  
Vice President, Technical Activities  
Financial Executives International



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Technical Director  
File Reference No. 1600-100  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

**Re: Disclosure of Certain Loss Contingencies - an amendment of FASB Statements No. 5 and 141(R)**

Dear Sir:

The Committees on Corporate Reporting (“CCR”) and Government Business (“CGB”) of Financial Executives International (“FEI”) appreciate the opportunity to share their views on the proposed Statement of Financial Accounting Standards – “Disclosure of Certain Loss Contingencies – an amendment of FASB Statements No. 5 and 141(R) (the “ED”). As discussed more fully below, CCR and CGB (“the committees”) are very concerned about the implications the ED will have, if finalized in or near its present form, on the accounting and disclosures of loss contingencies related to litigation; particularly the prejudicial effects these changes will have on ongoing and threatened litigation. The implications of the ED for litigation will be the main focus of this letter. We note, however, that the ED extends to contingent liabilities other than litigation and we provide our views thereon as well. Also discussed are the impacts of this ED on dealings with regulatory entities.

FEI is a leading international organization of senior financial executives. CCR is a technical committee of FEI, which reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. CGB formulates positions and comments on government policies that impact FEI members doing business with all sectors of the federal government. The members of CGB are drawn from a broad cross-section of companies which do business with the government. This document represents the views of CCR and CGB and not necessarily the views of FEI or its members individually.

**Executive Summary:**

The committees believe that, with respect to litigation-type contingencies, the ED will be extremely prejudicial to the interests of preparers as well as to current *and* future investors and other users of a company’s financial statements. Accordingly, we strongly recommend that this project (i.e., the disclosure phase of the larger project reconsidering contingency accounting and disclosure) not proceed further. We acknowledge the Board has stated that it does not intend for the proposed revisions of FASB Statement No. 5,

*Accounting for Contingencies* (“FAS 5”), to compel disclosures that are prejudicial to the interests of a financial statement preparer. However, we believe that any incremental disclosures, other than a public domain-based factual description of the legal action, could potentially be useful to a plaintiff. Further, we believe that if the expectation of any revision to FAS 5 is for more information about what management knows and thinks about pending litigation then it will be difficult for companies to avoid providing disclosures that would, or could, be prejudicial – the ED’s remedy for prejudicial exemptions notwithstanding. Moreover, we believe that these disclosures will not be meaningful given the complex nature of these contingencies and their inherent unpredictability. We have attempted to identify a middle ground between current requirements and the ED through careful study of the ED’s requirements. Unfortunately we cannot identify any meaningful compromises between our views as expressed below and the principles in the ED that would simultaneously: (1) provide meaningful incremental disclosures to financial statement users and (2) protect the rights and legal interests of preparers in their role as defendants in lawsuits.

We have fewer, but nonetheless significant, concerns regarding the ED’s requirements for non litigation contingencies; however, we question whether there is a compelling need for an additional disclosure standard solely in this area. Lastly, we note a proposed effective date commencing with year end 2008 reporting. While we strongly believe the ED should not be finalized, we are also concerned with the practicalities of completing this controversial standard in the very near future and essentially making it effective immediately. Should the Board proceed with this project, we strongly encourage a delay in the effective date until no earlier than the end of 2009. Our views on the ED are discussed in detail below.

**The ED is at variance with the needs of financial statement users and management’s fiduciary responsibilities:**

We note that the Board believes that the users of financial statements are concerned about the apparent lack of meaningful disclosures regarding loss contingencies, especially litigation. Accordingly these expressed concerns are the primary driver behind this project to expand disclosures about such contingencies. The committees believe that the user community does not hold as unanimous a view as the Board suggests. There are many types of financial statement users, each with different needs and motivations. We believe there are important constituents within the broad category of financial statement users, such as current shareholders and buy side analysts who, in a vacuum, might want additional litigation disclosures along the lines of the ED, but in general do not want such incremental information at the risk of potentially damaging the company – and their investment.

While we find that these disclosures will affect all investors negatively, management’s fiduciary responsibility is to current – not future - shareholders. Vis-à-vis this responsibility, we believe that the ED compromises a company’s management and external directors by requiring the disclosure of information that is potentially harmful to current shareholders. We acknowledge that management also has a reporting and disclosure obligation to future investors and other users of a company’s financial statements however, in our opinion, this obligation is adequately addressed by the current FAS 5 disclosure requirements as well as the various disclosure requirements of the Securities and Exchange Commission (“SEC”). Further, we do not believe that disclosure obligations to future investors should take priority over management’s fiduciary responsibilities to current shareholders; stated differently, current shareholders

should not be injured to serve the potential needs of other categories of financial statement users. Management always has the option to make voluntary disclosures regarding the status of litigation but should not be compelled to do so beyond the current requirements of FAS 5 and the related practices that have developed over the years.

The committees further submit that the expanded disclosures recommended in the ED would actually be harmful to both current and prospective shareholders for the following reasons:

- Litigation is inherently unpredictable; the path towards resolution is long and winding, with frequent changes in direction. Major litigation is dynamic and transitory; it has numerous ups and downs and management's assessment will frequently change as new information or legal theories emerge, settlement and trial strategy evolve, venues change, judges are assigned, rulings are issued, and appeals are made. Further, there are situations where, for short windows of time, it may be tactically advantageous to settle a claim but not so advantageous to do so later. Our concern is that the significantly expanded disclosures (versus current practice) related to the status of open litigation and potential outcomes mostly provide information useful only to a company's legal adversaries. We do not believe this information would be useful to a typical investor especially when disclosed without the fuller context that a plaintiff would have.
- We believe the expanded litigation disclosures contemplated by the ED will frequently lead to investor confusion and poor investor decision making. This is because, if made properly, the disclosures will often be very technical and are capable of being properly understood only by those closest to the situation. Providing insight into the details surrounding a company's exposure to loss along with an assessment of its potential effects and the critical assumptions made by the company in reaching its assessment assumes a level of sophistication and understanding of complicated legal issues on the part of the investor that is unrealistic. What may seem to an ordinary investor to be a good, or bad, development may be little more than a routine step in the litigation process. As a consequence investor decisions would frequently be based on an incomplete understanding of the situation: the exact problem the expanded disclosures attempt to rectify. The ED seeks to have investors assess management's decisions about the outcome of contingencies based on summary information in footnotes disclosures, yet such situations are rarely able to be understood, much less assessed, without an in depth analysis of an extensive amount of information. In short, the objective of the ED is simply unobtainable.

**The existing FAS 5 disclosure requirements adequately address the needs of current and prospective shareholders:**

FAS 5 has been in place for over 30 years and represents an excellent example of a principles-based standard that has worked well over many years. Its requirements and limitations are well understood by all relevant parties and working protocols in the legal, audit, and preparer community have emerged over the years. FAS 5 requires disclosure of loss contingencies if the potential exposure is at least reasonably possible of occurring and if the potential for loss is material. Properly prepared footnote disclosures put the user of financial statements on notice that, in lay terms, there is a very good chance that a material adverse event may occur. We submit this is sufficient disclosure in most circumstances – especially for prospective shareholders and other non-investor

users. Just as there is nothing that prohibits companies from making voluntary disclosures, there is also nothing that prohibits financial statement users from doing independent research about the nature and potential outcome(s) of the contingency. We believe it is in fact their responsibility to do this research if they consider the matter important enough; conversely they should not expect current management to disadvantage current shareholders for the benefit of future shareholders. Lastly, we also know that efficient markets factor in the uncertainty of such contingencies into share price valuations, credit ratings, etc. There are frequently many sources of non privileged information and analysis available to prospective shareholders should they wish to do their own independent research. Accordingly, we believe management is best positioned to determine the point at which incremental disclosures benefit, rather than harm, a company and/or its shareholders.

### **The ED is establishing an untenable new standard for loss estimation:**

FAS 5 has a long established 'if reasonably estimable' threshold for quantifying loss disclosures. The ED replaces this standard with a 'best estimate of maximum exposure to loss' standard if an amount has not been claimed or asserted. It further goes on to require that the assumptions used in establishing such estimate shall also be disclosed. Lastly, the ED permits disclosure of the entity's best estimate of possible loss if the claim or assessed exposure is not considered representative of the entity's actual loss exposure. We have several significant concerns with these requirements. We do not believe it is appropriate for a defendant company to disclose an estimate of maximum exposure in adversarial proceedings where the plaintiff has been unwilling or unable to provide such an estimate. This is in effect expecting the defendant to do the plaintiff's job. As plaintiffs have no obligation to release similar types of information, the Board has created an information asymmetry which disadvantages defendants in favor of plaintiffs. Also, because the defendant presumably has more internal information and institutional knowledge about the contested matter than the plaintiff, by preparing the maximum exposure to loss analysis, discoverable documentation has been created, a great deal of which would have been prepared by counsel, and thus properly privileged, which in addition to the disclosures, can and will be used against the defendant during the proceedings, if the legal privilege is breached arising from these disclosures. Accordingly, the estimate of maximum loss may very well become self-fulfilling.

The ED's proposed requirement to estimate the exposure to loss at such an early stage is at variance with how the U.S. judicial process works. The burden of proof as to liability and damages almost always rests with the plaintiff; the defendant technically needs to do nothing. We find it incongruous for a defendant company to simultaneously assert it is 'innocent' (as presumably it will) but at the same time to be required to calculate and communicate potential damages. To calculate maximum exposure to loss requires assumptions about the legal theories applicable to the case. Frequently, many different legal theories could be asserted which will have significant implications on the estimated amounts. We believe it is the plaintiff's responsibility to assert the legal theory or theories that will drive the proceedings. While the plaintiff may initially do so early on, the defendant may be aware of additional theories that could potentially be used and later asserted; it would not be in the best interests of current investors for management to do the plaintiff's analysis and research.

While we can understand the rationale as to why the Board proposes to require disclosure of plaintiff asserted monetary amounts of damages, we believe this disclosure should be an optional, rather than a required, disclosure. This is because plaintiff

asserted amounts are inherently biased and frequently grossly exaggerated. We believe being required to disclose a biased claim for damages undermines the notion expressed in paragraph 33 of Concepts Statement No.1 that “the role of financial reporting requires it [the company] to provide evenhanded, neutral or unbiased information.” To change this current well-principled approach would improperly place the decisions for required reporting into the hands of the defendant company’s adversaries, rather than in the hands of its own Board of Directors and management.

There are no guidelines for determining the ‘maximum exposure to loss.’ Accordingly we cannot envision there being any meaningful consistency and comparability in practice. Different in-house or outside trial attorneys may have very different, but entirely plausible, professional opinions as to what constitutes the maximum exposure to loss including their ability to predict the unpredictable - namely jury verdicts. Accordingly we do not believe any meaningful and/or reliable estimate of maximum exposure can be made until very late in the proceedings (e.g., after discovery and expert witness procedures and possibly later). We believe requiring disclosure of an inherently unreliable amount diminishes, rather than enhances, the usefulness of financial statements. At best, disclosure of the maximum exposure to loss is marginally useful to a very small subset of financial statement users. We believe, however, that disclosure of marginally useful information, for the majority of financial statement users, reduces the effectiveness of the financial statements by increasing complexity, communicating potentially prejudicial information and obscuring more important disclosures.

**Qualitative disclosures will frequently be prejudicial to the reporting entity:**

We do not object to standardizing certain qualitative disclosure requirements about pending litigation provided they are fact-based and otherwise available in the public domain. These would generally include description of the contingency; how it arose, the venue; current status (e.g. in discovery), scheduled court dates and the like. However we strongly disagree with being required to provide qualitative assessments as to the ultimate outcome of the case including the factors that could affect that outcome. Such disclosures would inherently require the advice of counsel, and could thus be highly prejudicial and could risk the waiver of the company’s attorney/client or attorney work-product privilege. This will only provide useful insight as to a defendant’s strategy and thinking – information that has traditionally been highly protected by companies and the courts to enable a proper defense. Such disclosures will simultaneously help a company’s adversaries and injure current investors. In our view these disclosures may become admissible evidence by themselves and can be expected to occasionally (or more frequently) alter the ultimate outcome of a proceeding. The committees believe that the expanded disclosures proposed by the Board are not neutral and would potentially be harmful to financial statement preparers and their current shareholders. We do not believe this is what the Board intended but it will be an unintended consequence. We will discuss later our views on the ED’s prejudicial exemption.

**The ED negatively affects attorney-client and attorney work product privilege:**

The committees do not believe it is possible to provide the disclosures required by the ED without the waiver of attorney-client and perhaps more importantly attorney work-product privileges. The disclosures themselves may directly constitute waiver. There are multiple new legal analyses that would be required to be regularly prepared for several of the ED’s requirements including: proof that a loss associated with a claim is/is

not likely to be remote; the determination of maximum exposure to loss; the best estimate of potential loss if the maximum exposure is not representative of actual exposure; description of the factors that will affect the ultimate outcome of a case; the assessment of the most likely outcome and the establishment that discrete disclosure is likely to be prejudicial; etc. The mere preparation of these analyses leads to the concern that the documents may become discoverable in due course. Perhaps, more importantly, since the disclosures would appear in an audited footnote, the underlying analyses would need to be shared with a company's independent auditors who would be expected to inspect and challenge them (and potentially require additional analyses as well as copies for their files). The act of providing this information, by definition, results in a loss of privilege because the party to which the information is given (the auditor) is not party to the attorney-client relationship. Attorney-client and attorney work product privileges are protected rights throughout the U.S. legal system – in fact the attorney-client privilege is the oldest privilege recognized under common law. These rights have been upheld by the Supreme Court of the United States. In our opinion, compliance with the Board's disclosure recommendations may require waiver of these protected rights. We believe it is inappropriate for the Board to require companies to prepare these disclosures in circumstances in which an adversary could not otherwise obtain them. We would not be surprised that if this ED is finalized at or near its current form that at some time there could be a legal challenge to the standard's requirements from those concerned with being forced into disclosures or into waiving privilege.

**The ED requires new and/or revised auditing procedures and guidelines:**

We do not believe the public accounting profession is positioned to audit the ED's required disclosures. We believe numerous changes to existing auditing guidance and/or procedures are required to enable the independent auditor to document, test and conclude on the disclosures and to render an unqualified opinion on a timely basis. We cite three specific examples as illustrative of the larger concern:

- We believe the long standing American Bar Association – American Institute of Certified Public Accountants treaty on attorney responses to auditor requests for information and representation will need to be re-visited prior to any effective date of this ED. The current treaty was written in the context of FAS 5 requirements; since the ED goes considerably beyond the requirements of Statement No. 5 we do not believe the current treaty will be operative against the requirements of the ED. Since, in our view, the ED appears to encroach upon legally protected rights we do not see how a revision to this treaty can happen quickly – if at all.
- The Public Company Accounting Oversight Board (“PCAOB”) will need to issue guidance as to expected and/or required procedures to audit the ‘maximum exposure to loss’ disclosures. Since there are no current guidelines for the legal profession to make this assessment, likewise there are no guidelines for auditors to follow when testing the assertions. The situation is not as easy as relying on an attorney representation letter – assuming one can be obtained. For example, what happens if in-house counsel and external counsel do not agree on the maximum loss? Major litigation may have several law firms involved – how does the auditor (and management) reconcile differing legal opinions? Does the estimation process assume a jury trial or a settlement? Does the auditor (and management) assume the venue the case is brought in remains the venue for the duration of the proceeding? If the matter is brought in a state venue, does one need to consider that the case may eventually move into the federal system?

Many additional questions could be posited. Different audit firms may have different professional opinions as how to interpret and apply the phrase 'maximum exposure to loss'. If this project moves forward at or near its current form, our recommendation is for the PCAOB to issue guidance to the public accounting profession before the ED is effective in order to ensure there is a cost-effective and system-wide consistent audit approach for all registrants.

- The ED states that use of the prejudicial exemption is expected to be 'rare'. We acknowledge the ED notes that 'rare' does not mean 'never'. We believe that experience will quickly result in more frequent use of the exemption than the Board intends. The Board, and the PCAOB, will need to address how 'rare' should be applied. For example, for litigation within a company; for litigation across a public accounting firms' clients; what happens when a situation that at one time qualified for the 'rare' exemption no longer qualifies as 'rare' and vice versa; what if the 'rare' exemption can be justified on a case by case basis but the end result is that, in the aggregate, large portions of litigation are covered by the 'rare' exemption and therefore the ED does not achieve its designed intent, etc.

In summary, we believe there are important and necessary changes in audit requirements that need to be addressed before the ED could be operable. While perhaps not insurmountable, we believe the challenges are significant and require guidance which will take a considerable amount of time to develop and certainly not in time for year end 2008 reporting.

**The proposed prejudicial exemption is not adequate:**

We appreciate the Board's attempt to provide an exemption from disclosure if the disclosure is considered prejudicial. We have carefully studied the proposal and do not believe that, as drafted, it will achieve the desired affect. First, there is already a stated bias in the ED in that use of this exemption is expected to be 'rare'. With the expectation in the ED for greatly expanded disclosures about loss contingencies, we envision it will be very difficult to make effective use of the exemption provided. Further, for companies involved in only one or a few major lawsuits it would not be difficult for an astute reader of its financial statements to determine which litigation is being referred to in the aggregated disclosures. We also observe that the only disclosures that may be omitted are those that are viewed as prejudicial; this means all other required disclosures remain. We can envision this leading to painstaking parsing of facts and other details as to what is, versus what is not, prejudicial. Broadly speaking, in our view anything that is incremental information can be viewed as potentially prejudicial. While the aggregation exception may on occasion have the desired effect for the quantitative disclosures, we believe it will extremely difficult, if not often impossible, to meaningfully aggregate the qualitative disclosures.

**The ED will impair compliance with certain requirements of the Sarbanes-Oxley Act:**

While not central to our technical and theoretical concerns with the ED, the Sarbanes-Oxley Act requires quarterly certification by the CEO's and CFO's as to the adequacy of disclosures and compliance with regulatory requirements – the Section 302 and 906 certifications. Specifically, the certification states, "Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such

statements were made, not misleading with respect to the period covered by the report.” Given all of the concerns outlined in the preceding pages coupled with the unreliability of estimates, the inherent unpredictability and adversarial nature of litigation and the real potential for such disclosures to actually mislead investors, we do not see how, in good faith that the CEO and the CFO of any company which has significant litigation can sign these certifications. Similarly Section 404 of the same Act requires testing of the sufficiency of internal controls over significant financial statement assertions. Given the nature of the required disclosures, the interaction with the legal profession, the absence of guidelines as to how to estimate the ‘maximum exposure to loss’, our concerns with how to apply the ‘rare’ prejudicial exemption among other problems and concerns, it is critical that the PCAOB or the SEC, as appropriate, develop and publish guidelines as to their views as to how management and independent auditors should approach these matters. We believe this is a necessary pre-requisite before any effective date of the ED should the Board persist in finalizing it at or near its current form.

### **Relationship of the ED to IAS 37 – Provisions, Contingent Liabilities and Contingent Assets:**

We understand that the Board considers the disclosure requirements of the ED to be largely consistent with the requirements of IAS 37 including the IASB’s 2005 Exposure Draft to amend IAS 37. We also understand that the Board believes the disclosure requirements under IFRS are not particularly controversial in IFRS-based reporting environments. We have the following observations:

First, with respect to similarities and differences between the ED and IAS 37 (including the related 2005 ED proposing amendments) we believe there are significant incremental disclosures recommended by Board which are not found in either IAS 37 or its ED. In particular, we do not see where the IASB’s proposed changes to IAS 37 require disclosures of: company estimates of maximum exposure to loss; insurance and indemnification arrangements and certain of the paragraph 6 disclosures. Further, this ED has been in existence for three years and has received over 120 comment letters – all evidence that the proposed changes are at least somewhat controversial.

Second, even if one accepts the premise that the IASB’s requirements are not especially controversial in IFRS environments, we believe that the explanation is rooted in the fundamental differences between the legal environments in the United States and the rest of the world. In our opinion the volume of litigation – especially tort type litigation – is vastly greater in the United States than in many countries. The existence of socialized medicine; national health care and wage protection serve as reductions to the volume of litigation in many countries – in effect national no fault insurance. Further, in many countries the concept of punitive damages does not exist. In addition, in certain countries the loser of civil litigation pays the other side’s legal and other out of pocket costs. In more recent decades, the tort system in the United States evolved into something more than primarily a method of compensating victims; damages awards became a device for economically de facto regulating defendant behavior (e.g. product safety in manufactured goods). Our list could go on to great length. Tort reform as the Board is aware is a major, and politically sensitive, subject in the United States – in and of itself evidence of an issue. Our objective is not to take a pro or con position on the relative merits of legal systems; it is only to point out that there are significant differences in the underlying legal environments such that the acceptability of IAS 37 may be less of a business issue internationally than the ED is in the United States.

### **Contingencies other than litigation:**

Thus far our comments have almost exclusively focused on litigation contingencies. Since litigation contingencies appear to be the major financial reporting concern prompting this project, we are uncertain if there is a compelling need for this project if, for whatever reason, litigation was excluded from its scope. There are already numerous contingent liability disclosures required by existing pronouncements: e.g. by FAS 5, FASB Statement No. 146, FIN 45, FIN 48, SOP 94-6; SOP 96-1, etc. In addition, the SEC has numerous disclosure requirements with respect to contingent obligations. We question how many other types of contingencies exist which are not already covered by one or more existing pronouncements? In our view, many of the ED's recommended disclosures are already required in other pronouncements and while it may be useful to put them all in one standard we believe the codification project will achieve much of this objective. Further, given the focus of the Board to prioritize its agenda projects, we believe this project can safely be demised.

Many of the concerns expressed above also apply to non litigation liabilities; however, in the event that this project does continue forward, despite our strenuous objections, we have the following comments with respect to the non-litigation contingencies within the scope of the ED:

- We believe the Board needs to clarify scope paragraph 3b as the current wording appears to be ambiguous. We understand that some readers are interpreting this paragraph as excluding only guarantees covered by FIN 45 while other readers are interpreting it as excluding all issues covered by FIN 45.
- We agree with the Board's decision to allow for aggregation of similar types of contingencies. With respect to disclosures required under paragraph 7 of the ED, we advise that for multinational corporations the data gathering and estimation processes will be significant work activities. Our sense is that few, if any, corporations are currently organized to accomplish these tasks and it will be a considerable burden to put the necessary procedures in place by the end of 2008 or even for quarterly reporting in early 2009. To illustrate the challenge; assume the subject is product liability for products sold worldwide which are deemed defective and subject to recall. Some of the issues and questions that need to be answered include: identification of each local law or regulation that applies; determining the obligations to the company; identifying the nature of the exposure – in some countries the answer could be product replacement, in others monetary compensation; in some countries there could be punitive damages; establishing which portion of the sold products are actually defective; analyzing insurance coverage which may vary around the world with variable deductibles; in some countries there may be no obligation at all; if local court systems are involved what are the local precedents vis-à-vis determining liability? If there is a regulator (e.g. the Consumer Product Safety Commission) does the contingent liability extend to regulatory fines and penalties or only to obligations due to injured customers? The list could go on but we believe the point is made that for large corporations this will be a major undertaking if they have consequential contingent liabilities. Typically, when exposures on items such as these are considered less than probable, they frequently are below management's immediate line of sight and would not receive the attention and analysis required by the ED. Alternatively they may be viewed as ordinary

course of business items for which there is no particular internal need of the corporation to gather the particular types of data and analyze it in the manner that the ED would require. Accordingly, we believe it will be extremely onerous to properly adopt the ED's requirements before the end of 2009, if then.

- Many companies have large, well established self insurance programs which appear to be in the scope of the ED. However, the ED excludes insurance companies from its scope. Assuming a self insurance program is well controlled and following current accounting principles, it appears self insuring companies will be subject to different disclosure requirements versus the rest of the insurance industry. Since the Board concluded, appropriately in our opinion, that insurance companies should, for the most part, be out of scope we believe it is also appropriate to exclude the self insurance programs of reporting companies from the ED's scope as well.
- Companies who are contractors for the U.S. Government are subject to compliance with Cost Accounting Standards Regulations and Federal Acquisition Regulations in addition to the financial accounting standards. Disputes regarding differences in interpretation of these additional regulations which impact government contracts are not uncommon and are often resolved through negotiation or litigation. Either method of resolution is generally lengthy and unpredictable in both timing and outcome, such that disclosure as proposed in the ED would be difficult, if not impossible, to meaningfully predict. In addition, disclosure of disputed items could be prejudicial to their outcome.
- Many contingencies may commence as a regulatory matter or a self determined action – e.g. a voluntary product recall. However over time we believe many will eventually evolve into civil litigation; in those circumstances, our concerns expressed throughout this letter apply.

#### **Effective Date:**

The ED proposes an effective date for 2008 year end reporting. For reasons expressed in this letter we strongly believe the ED should not be finalized. Should the Board proceed in finalizing the ED we cannot envision the ED being effective for year end 2008. There are less than five months left in 2008; the staff and Board will not have had time to analyze comment letter responses; the roundtables have not occurred; the Board has not had time to re-deliberate or to prepare a final document, etc. Properly done, these due process requirements would normally take at least three months. Further, from a financial statement preparer perspective, the necessary systems, data gathering and evaluation requirements have not been developed or deployed to conform to the proposals in the ED. This is particularly problematic for decentralized multinational corporations where the underlying information is all over the world. We again note the need for re-consideration of the ABA-AICPA treaty and for PCAOB guidance in certain areas. For all these reasons we cannot foresee a viable effective date before the end of 2009 or later.

#### **Summary**

As detailed above, CCR and CGB are extremely concerned about the disclosure requirements recommended in the ED. We believe FAS 5 as it relates to litigation

contingencies has worked reasonably well over the past three plus decades and remains an excellent example of a principles based accounting standard. Its requirements and limitations are well understood by all relevant parties and working protocols have emerged over the years. We acknowledge that situations have occurred when companies recognized litigation losses and a review of prior disclosures may not have provided sufficient warning of the impending losses. However we suspect that if these situations are analyzed that many of the losses were also unforeseen by management and that the 'surprise' loss occurred due to the difficulty of assessing litigation outcomes rather than a conscious decision not to provide disclosures. It is our experience that very frequently, probably more often than the Board realizes, litigation losses are not reasonably estimable, until a conscious decision is made by both parties to settle. Our experience also indicates that once the decision is made to seriously attempt a settlement, that events move quickly and meaningful monetary amounts are only then discussed. This is obviously at the very end of the process and frequently years after the litigation process begins.

The litigious environment in the United States is much more active than in most of the rest of the world and consequently we believe analogy to other environments (and by extension to IAS 37) is not an appropriate comparison. We do not believe companies can comply with the letter and spirit of the ED without possibly compromising or waiving fundamental rights embodied in U.S. law. With respect to non litigation-based contingent liabilities we are not convinced as to the need for a new standard in this regard because of substantial pre-existing disclosure requirements in current standards.

In conclusion, we strongly recommend to the Board that the ED not be finalized.

\* \* \* \* \*

We appreciate the Board's consideration of these matters and welcome the opportunity to discuss any and all related matters. We note the Board is planning roundtable meetings to more fully vet the concerns of the preparer community and other constituents; we strongly endorse the planned roundtable(s) and have notified the FASB staff of FEI's interest in participating.

Attached as Exhibit I is a list of co-signors to this letter. Each of them is a senior financial executive of their company and a member of CCR. We ask you to recognize the breadth and diversity of companies they represent. Many of them will have incremental additional concerns with the ED and may not necessarily agree with every concern we have raised exactly as stated. However we want the Board to understand how strongly the individual committee members feel about the concerns expressed in this letter.

Sincerely,



Arnold C. Hanish  
Chairman, Committee on Corporate Reporting  
Financial Executives International



Dale E. Wallis  
Chairman, Committee on Government Business  
Financial Executives International

cc:

Mr. Christopher Cox, Chairman  
Securities and Exchange Commission

Mr. Mark Olson, Chairman,  
Public Company Accounting Oversight Board

Sir David Tweedie, Chairman,  
International Accounting Standards Board

**Exhibit I – co-signing companies to accompanying letter to the FASB**

Ms. Giovanna Acquilano  
Vice President Accounting Policies  
JPMorganChase

Mr. Harry Anderson  
Vice President and Controller  
The Coca-Cola Company

Mr. Lonnie Arnett  
Vice President, Controller and Chief Accounting Officer  
Dresser-Rand Group Inc.

Mr. Rudolf A. Bless  
Chief Accounting Officer  
Credit Suisse Group

Mr. Frank H. Brod  
Corporate Vice President, Finance & Administration & CAO  
Microsoft Corporation

Ms. Loretta V. Cangialosi  
Senior Vice President and Controller  
Pfizer Inc.

Mr. Jonathan Chadwick  
SVP, Corporate Controller and Principal Accounting Officer  
Cisco Systems Inc.

Ms. Leslie S. Culbertson  
Vice President , Director Finance  
Intel Corporation

Mr. Nick Cyprus  
Controller and Chief Accounting Officer  
General Motors Corporation

Mr. John Davidson  
SVP, Controller and CFO  
Tyco International (US) Inc.

Ms. Talia M. Griep  
Vice President and Controller  
Honeywell International Inc.

Mr. Arnold C. Hanish  
Executive Director Finance and Chief Accounting Officer  
Eli Lilly and Company

**Exhibit I – co-signing companies to accompanying letter to the FASB Cont.**

Mr. Kenneth N. Heintz  
Corporate VP, Controller and CAO  
Northrop Grumman Corporation

Mr. W. Ron Hinson  
SVP, Comptroller & CAO  
Southern Company

Mr. Mick Homan  
Comptroller, Corporate Accounting  
The Procter & Gamble Co.

Mr. Gary Kabureck  
Vice President & Chief Accounting Officer  
Xerox Corporation

Mr. Kenneth A. Kelly Jr.  
Senior Vice President & Controller  
McCormick & Company Inc.

Mr. Mark A. McCollum  
Executive Vice President & CFO  
Halliburton Company

Ms. Christina McMullen  
Vice President & Controller  
The Black & Decker Corporation

Ms. Jamie Miller  
Vice President & Controller  
General Electric Company

Mr. John B. Morse, Jr.  
Vice President Finance and CFO  
The Washington Post Co.

Mr. Patrick T. Mulva  
Vice President and Controller  
Exxon Mobil Corporation

Mr. Barry J. Niziolek  
Vice President & Controller  
E. I. du Pont de Nemours & Co.

Ms. Billie K. Rawot  
Senior Vice President & Controller  
Eaton Corporation

Mr. Marc Rothman  
Senior Vice President and CFO Mobil Devices  
Motorola Inc.

**Exhibit I – co-signing companies to accompanying letter to the FASB Cont.**

Ms. Margaret M. Smyth  
Vice President, Controller  
United Technologies Corporation

Mr. Thomas M. Tefft  
Vice President, Corporate Controller  
Medtronic Inc.

Mr. Tony R. Thene  
Vice President and Controller  
Alcoa Inc.

Mr. William Weideman  
Vice President & Controller  
Dow Chemical Company

Mr. Scott Woltemath  
Vice President of Finance  
Dell Incorporated

Mr. Steven K. Young  
Senior Vice President and Controller  
Duke Energy Corporation



## Committee on Private Companies

August 8, 2008

Financial Accounting Standards Board  
of the Financial Accounting Foundation  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856-5116

Attn: Technical Director  
File Reference No. 1600-100

The Standards Subcommittee of the Committee on Private Companies (CPC) of Financial Executives International (FEI) wishes to share its views on the Exposure Draft (ED) of Proposed Statement of Financial Accounting Standards *Disclosure of Certain Loss Contingencies, an amendment of FASB Statement No. 5 and 141(R)*. FEI is the leading advocate for the views of corporate financial management in the United States. It is a professional association of more than 15,000 CFOs, Treasurers, Controllers, and other senior financial managers. With approximately 7,500 members from private companies, FEI has a strong base of knowledge on which to draw with regard to the financial reporting needs and requirements of the private sector.

The CPC is a technical committee of FEI which formulates private company positions for FEI, considering the views of its membership. The CPC's views represent those entities that do not have public accountability and publish general purpose financial statements. This letter represents the views of the CPC's Standards Subcommittee, as a whole, and not necessarily the views of FEI. The size of our private companies range upward to in excess of \$1 billion in revenue. The respondents to a recent survey of FEI indicate that 51% of their companies have revenues above \$100 million, and about 10% have revenues above \$1 billion. Throughout this comment letter, the term "company" is used interchangeable with "entity" or "entities."

### **In Summary:**

**The constituency requesting increased disclosure of loss contingencies is driven by investment analysts and others, who are attempting to value public companies and compare one public company to another for investment purposes. This is not the case for private companies as many private companies are not evaluated in the same manner as public ones. Some private companies' stocks are not valued; others are based on formulas relating to business metrics including book value, net worth, etc.**

**Private companies do not typically issue interim financial statements as most may be required, by debt agreements, to issue statements on an annual basis to private investors, shareholders and banks within a specified period of time at the conclusion of a fiscal year reporting period. In addition, private companies are not precluded from meeting and discussing issues affecting the business, including loss exposures, on a periodic basis with bankers, private investors and shareholders. Typical private company banking and credit agreements contain language requiring prompt notification in the event of any proceeding which if adversely determined, would be expected to have a "material adverse effect". The "material adverse effect" clause under which private companies must operate is a lesser threshold than the requirements of "severe impact",**

which footnote number 2 of the ED says has a “higher threshold than material”. As a result, private companies already comply with the spirit and intent of the ED.

Furthermore, the SEC provided an exemption to smaller public companies from compliance with item 305 information including disclosure of risk factors and they are no longer required to provide tabular disclosure of contractual obligations. Therefore, requiring increased disclosure of loss contingencies for private companies will add costs and complexity, while providing little additional value to private companies stakeholders. As a result, we recommend private companies be exempt from compliance with this proposed statement.

***1.a. Will the proposed Statement meet the project’s objective of providing enhanced disclosures about loss contingencies so that the benefits of those disclosures justify the incremental costs? Why or why not?***

FEI CPC Standards Subcommittee Comments:

No. The Statement as proposed would increase disclosures, but not necessarily clarify reasonable or realistic exposure. General purpose financial statements are inherently filled with estimates. Making these estimates more objective is valuable to users, but no amount of objectivity or disclosure of possible contingencies will allow financial statements to answer all questions users may have about an entity’s operations or financial position. Different user groups have different points of view or concerns and may be interested in executive compensation, environmental activities or liabilities, ability to generate future cash flows or the security of obligations owed.

It is not possible to make contingencies certain. Existing standards require adequate disclosure to inform users of contingencies and their possible outcomes. Informing users of remote contingencies is currently not required and in fact does not provide objectivity given the speculative and unsubstantiated nature of the certain of the information required under the Statement. Existing auditing standards, properly applied, attest that proper disclosure has been provided. In our opinion, weaknesses have resulted more from the lack of objective adherence to existing standards and a failure by auditors to apply existing audit standards to disclosures, not from an inherent weakness in the existing disclosure requirements.

Furthermore, the constituency requesting increased disclosure of loss contingencies is driven by investment analysts and others, who are attempting to value public companies. This is not the case for private companies as many private companies are not evaluated in the same manner as public ones. Some private companies’ stocks are not valued; others are based on formulas relating to business metrics including book value, net worth, etc. Ultimately, increasing loss contingency disclosure requirements will add more complexity, greater confusion and will result in increased cost without any appreciable benefit to readers of the general purpose financial statements.

***1.b. What costs do you expect to incur if the Board were to issue the proposed Statement in its current form as a final Statement?***

FEI CPC Standards Subcommittee Comments:

As private companies we would expect to incur significant increased cost of compliance in several areas. The proposal will cause an increase in both internal compliance costs and external costs from both legal and audit fees, as attorneys and auditors will perceive greater scrutiny and liability associated with providing their responses and/or attestation. This increased expense burden, especially for private companies, will not result in better information to users, as the proposal does not address how the information is gathered, only the disclosure of the amounts and circumstances. For most companies, the underlying contingencies being disclosed should not change as a result of the proposal. Both public company and private company external consultants will likely error on the side of disclosing the most remote possibilities and exposure beyond the maximum exposure to protect them. In addition, given the nature of the information, the disclosures are likely to be heavily qualified, further limiting their value. This could lead to more inaccurate disclosures rather than more accurate ones.

***1.c. How could the Board further reduce the costs of applying these requirements without significantly reducing the benefits?***

FEI CPC Standards Subcommittee Comments:

For private companies, we believe that any incremental increase in compliance costs will outweigh the benefit to users of the proposed additional disclosures. The FASB staff suggests that there is a weakness in existing disclosures of contingencies. We do not believe that the dissatisfaction is a direct result of a weak standard. The existing standard's principles are used throughout financial statements in many ways not explicitly covered by the statement and is considered a general underpinning of financial statement accrual and disclosure theory.

Adherence to the existing standard may be inconsistently applied, however. Management may not disclose existing contingencies properly and auditors may not challenge the adequacy of disclosures with enough vigor, or may not use existing audit standards to uncover all existing contingencies. If the existing standards were consistently applied and audited with existing audit standards, we believe contingency disclosures would prove adequate for all general purpose financial statement users. Creating additional rules will not improve compliance with existing standards, but will degrade the importance of one of the most prominent principles-based standards.

***2. Do you agree with the Board's discussion to include within the scope of this proposed statement obligations that may arise from withdrawals from a multi-employer plan?***

No Comment from FEI CPC Standards Subcommittee

***3. Should an entity be required to provide disclosure about loss contingencies, regardless of the likelihood of loss, if the resolution of the contingencies is expected to occur within one year of the date of the financial statements and the loss contingencies could have a severe impact on the operations of the entity? Why or why not?***FEI CPC Standards Subcommittee Comments:

We believe that disclosure of loss contingencies that are remote or less than probable and expected to be resolved within one year will confuse rather than clarify an entity's financial position. The nature of some contingencies is that they may or may not have a definite settlement date. The time horizon and ultimate sustainability of a claim will be impacted by innumerable circumstances, many of which are not foreseeable. Legal disputes often are subject to settlement discussions, some of which culminate in a conclusion. Active settlement discussions do not always result in near term settlements.

The practical separation of which contingencies may be settled in the near term is not always an objective determination and the exposure draft will lead to disclosure of contingencies that will not actually be settled in the near term. Having this specific carve out from the general principle is counterproductive to a theory of contingency disclosure. All contingencies should be treated equally regardless of when they may be realized.

Removing the requirement to disclose all loss contingencies that are less than probable, even with the possible resolution within one year, would greatly enhance the clarity of the disclosure. Furthermore, we believe the requirement to disclose the maximum liability, rather than the most likely outcome will also distort the information and provide less, rather than more, clarity for understanding the financial position of an entity.

***4. The Board decided to require entities to disclose the amount of the claim or assessment against the entity, or, if there is no claim or assessment amount, the entity's best estimate of the maximum possible exposure to loss. Additionally, entities would be permitted, but not required, to disclose the possible loss or range of loss if they believe the amount of the claim or assessment is not representative of the entity's actual exposure.******4.a. Do you believe that this change will result in an improvement in the reporting of quantitative information about loss contingencies? Why or why not?***FEI CPC Standards Subcommittee Comments:

Disclosure of a maximum exposure for a contingency unfairly prejudices the reader to an extreme position. Disclosure of a best estimate with an appropriate discussion of the facts and assumptions is a

more appropriate disclosure because it provides a more balanced presentation of the circumstances and likely outcome. This likely outcome is also the test used in IAS 37. Specifically requiring disclosure of a worst case scenario and immediately thereafter disclosing management's view that the worst case amount is not realistic will only confuse the reader. Readers understand that management prepares the financial statements and disclosures; the presentation of differing points of view within the same disclosure will not improve user understanding of potential contingencies but confuse the reader about the most probable outcome.

**4.b. Do you believe that disclosing the possible loss or range of loss should be required, rather than optional, if an entity believes the amount of the claim or assessment is not representative of the entity's actual exposure? Why or why not?**

FEI CPC Standards Subcommittee Comments:

We believe the disclosure should portray the most likely outcome or probable loss, rather than a range or maximum exposure. The range of outcomes could vary greatly, and more information is not necessarily better information.

**4.c. If you disagree with the proposed requirements, what quantitative disclosures do you believe would best fulfill the users' needs for quantitative information and at the same time not reveal significant information that may be prejudicial to an entity's position in a dispute?**

FEI CPC Standards Subcommittee Comments:

We believe the most effective disclosures provide the users with realistic valuation of the possible outcome resulting from a loss contingency. This would be best achieved by:

- Use of best estimate disclosures instead of maximum possible liabilities
- Clarify that remote outcomes should not be disclosed even if they are the maximum possible outcome of a probable contingency
- Reconsider the requirement that contingencies which may be resolved within a year be disclosed even if they are remote

**5. If a loss contingency does not have a specific claim amount, will an entity be able to provide a reliable estimate of the maximum exposure to loss (as required by paragraph 7(a)) that is meaningful to users? Why or why not?**

FEI CPC Standards Subcommittee Comments:

Claims are often made in litigation to intimidate the defendant and prepare for a settlement. Initial (or maximum) claim amounts rarely correlate to a settlement or adjudication amount. These claims are likely inflated, and disclosure of these would provide little value to the user. Again, a use of best estimate disclosures would provide more effective and accurate information than claim amounts or maximum loss exposures.

**6. Financial statement users suggested that the Board require disclosure of settlement offers made between counterparties in a dispute. The Board decided not to require that disclosure because often those offers expire quickly and may not reflect the status of negotiations only a short time later. Should disclosure of the amount of settlement offers made by either party be required? Why or why not?**

FEI CPC Standards Subcommittee Comments:

We agree with the Board's position, for the reasons cited and because disclosure of settlement offers would likely influence the outcome of the settlement and provide inaccurate information. Parties often propose positions in a strategy to achieve certain outcomes. Those positions may not truly reflect the position of the party, but represent a position to achieve an objective. Disclosure of these positions will not clarify, but rather confuse, the users. In addition, until a real settlement is reached, negotiation or settlement offers may be withdrawn at any time, leading to more confusion and misunderstanding. Settlement discussions are inadmissible as evidence to avoid inhibiting the settlement negotiations through the prospect of these discussions and settlement offers being aired in open court. The suggested disclosure would have a similarly negative impact.

**7. Will the tabular reconciliation of recognized loss contingencies, provided on an aggregated basis, provide useful information about loss contingencies for assessing future cash flows and understanding changes in amounts recognized in the financial statements? Why or why not?**

FEI CPC Standards Subcommittee Comments:

We believe the use of tabular reconciliations will lead users to believe that the estimates provided in a table of possible outcomes are factual and not true estimates. Loss contingencies contain significant judgment and estimates from Management, who often rely on outside experts to evaluate potential losses. Providing objective information will distort the true uncertain nature of these loss contingencies. Private companies will generally not have multiple loss contingencies that can be aggregated in a tabular presentation, leading to disclosure of possible losses that could be detrimental to the settlement of these losses. Therefore, we believe the use of tabular presentation, especially for private companies, will result in users drawing incorrect conclusions and could lead to influencing the outcomes of resolution. As a result, we do not agree with the Board's position and believe private companies should be exempt from disclosure. Alternatively, we recommend that private companies be allowed to aggregate all loss contingencies into one simple disclosure of only probable losses quantified at the most probable outcome.

**8. This proposed Statement includes a limited exemption from disclosing prejudicial information. Do you agree such an exemption should be provided? Why or why not?**

FEI CPC Standards Subcommittee Comments:

The exemption for prejudicial disclosure does not provide adequate exemption for some companies that have few contingencies, or a single contingency. Private companies or smaller companies often do not have the same number of contingencies and allowing a group presentation does not provide adequate protection from releasing prejudicial information. Entities cannot always control where financial statements go after they are released, even if confidentiality agreements are in place, as is the case with many private companies. Disclosure about a potential liability in a lawsuit to a counterparty could significantly prejudice the outcome as the proposal acknowledges, the grouping exemption will not benefit an entity with few contingencies from providing prejudicial information. Therefore, we believe the exemption, especially for private companies, should be expanded to cover all current or potential claims in litigation and or all disclosures that could prejudice the outcome if so disclosed.

**9. If you agree with providing a prejudicial exemption, do you agree with the two step approach in paragraph 11? Why or why not? If not, what approach would you recommend and why?**

FEI CPC Standards Subcommittee Comments:

We don't believe the aggregation approach will provide much protection for private companies, as they are likely to have few loss contingencies that can effectively be aggregated. Disclosure of loss contingencies in any form may prejudice the outcome. Therefore, we disagree with the two step approach and recommend only aggregation at the entity level of all loss contingencies for private companies to avoid possible impact on the outcome of a group or individual contingency.

**10. The existing disclosure requirements of IAS 37 includes a prejudicial exemption with language indicating that the circumstances under which that exemption may be exercised are expected to be extremely rare. This proposed Statement includes language indicating that the circumstances under with the prejudicial exemption may be exercised are expected to be rare (instead of extremely rare). Do you agree with the Board's decision and, if so, why? If not, what do you recommend as an alternative and why?**

FEI CPC Standards Subcommittee Comments:

See our response above to Question 8.

**11. Do you agree with the description of prejudicial information as information whose "disclosure ... could affect, the entity's detriment, the outcome of the contingency itself"? If not, how would you describe or define prejudicial information and why?**

FEI CPC Standards Subcommittee Comments:

Disclosure of any specific loss contingency has the effect of impacting its outcome to the detriment of the entity. Many, if not most, loss contingencies have legal aspects with determination based on negotiated settlement or litigation. Therefore, we agree with the description, but not on the rarity, of the circumstances. Material differences in the interpretation and application of the prejudicial information exclusion would fundamentally and negatively impact the consistency of the disclosures.

***12. Do you believe it is operational for entities to disclose all of the proposed requirements for interim and annual reporting periods? Should tabular reconciliation be required only annually? Why or why not?***

FEI CPC Standards Subcommittee Comments:

As loss contingencies change constantly and require evaluation from outside legal counsel and other outside experts, it is not practical to prepare and issue tabular reconciliations on interim financial statements.

***13. Do you believe other information about loss contingencies should be disclosed that would not be required by this proposed statement? If so, what other information would you require?***

FEI CPC Standards Subcommittee Comments:

No. We believe the ED requires more information than is necessary to adequately disclose loss contingencies.

***14. Do you believe it is operational for entities to implement the proposed Statement in fiscal years after December 15, 2008? Why or why not?***

FEI CPC Standards Subcommittee Comments:

With differences between the Boards recommendations on disclosure of loss contingencies and the position of IASB, combined with outstanding issues on the definition of *prejudicial information*, tabular presentation, etc., we believe it would be impractical to implement the proposed statement in 2009. We also believe this proposed statement will place an undue burden on private companies, while providing little benefit to users of their general purpose financial statements.

**Conclusion:**

**The constituency requesting increased disclosure of loss contingencies is driven by investment analysts and others, who are attempting to value public companies and compare one public company to another for investment purposes. This is not the case for private companies as many private companies are not evaluated in the same manner as public ones. Some private companies' stocks are not valued; others are based on formulas relating to business metrics including book value, net worth, etc.**

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We again repeat our appreciation for the opportunity to present our views on this ED. If you have any questions or wish to discuss our specific concerns, please feel free to contact me at 412-257-3885 or [Bill.Koch@ddiworld.com](mailto:Bill.Koch@ddiworld.com) or Serena Dávila at FEI's Washington, DC office at 202-626-7809 or [sdavila@financialexecutives.org](mailto:sdavila@financialexecutives.org).

Very truly yours,

A handwritten signature in black ink, appearing to read "William Koch". The signature is written in a cursive style with a large, stylized initial "W".

William Koch  
Chair, Standards Subcommittee  
Committee on Private Companies  
Financial Executives International