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The SEC Push for Enhanced Disclosure of Litigation Contingencies

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Over the last several days, there has been a raft of SEC filings in which companies have disclosed "reasonably possible" litigation losses. These filings are the result of SEC pressure and an interpretative position advanced by the Staff. In recent speeches, the Chief Accountant of the SEC's Division of Corporation Finance has questioned whether companies are complying with the existing disclosure standards applicable to litigation contingencies. ASC 450 (formerly known as SFAS 5) requires the disclosure of a litigation contingency if there is at least a "reasonable possibility" that a loss has been incurred, and the disclosure must include an estimate of the possible loss or range of loss or a statement that such an estimate cannot be made. The Chief Accountant has stated that the Staff is "seeing a lack of disclosure with respect to 'reasonably possible' losses." Moreover, in comment letters sent to various financial services companies, the Division of Corporation Finance has questioned the adequacy of litigation-related disclosures that do not either set forth estimates of possible losses or range of losses or explain why such estimates cannot be provided.

At a recent conference, the Chief Accountant also warned against over-reliance on the long-standing "treaty" between lawyers and accountants. In January 1976, the ABA and the AICPA agreed, among other things, on the substantive disclosure standards for loss contingencies arising from legal claims, including the above-referenced "reasonable possibility" standard. But the two professions have not always interpreted the "treaty" the same way. In particular, the ABA's general position, as reflected in its Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information, has been that lawyers should refrain from estimating potential losses because "the amount or range of potential loss will normally be as inherently possible to ascertain, with any degree of certainty, as the outcome of the litigation" and, therefore, "it is appropriate for the lawyer to provide an estimate of the amount or range of potential loss . . . only

if he believes that the probability of inaccuracy of the estimate of the amount or range of potential loss is slight."

Though he has cautioned that reliance on the "treaty" will not excuse noncompliance with ASC 450, the Chief Accountant has stated that a company's disclosure may state that an estimate cannot be provided "with certainty" or "with confidence" and therefore no estimate is provided. But he cautioned that the Staff may question a company's past failure to provide estimates when litigation settlements are disclosed thereafter. The Chief Accountant has also stated that disclosure of a "reasonably possible" range of loss may be done in the aggregate, which in some situations might make it more difficult for a company's litigation adversaries to ascertain its assessment of exposure in a particular litigation.

Reporting companies that are subject to International Financial Reporting Standards face a similar dilemma to those companies subject to ASC 450. Under IAS 37, unless the possibility of any outflow in settlement is remote, a company must disclose for each class of contingent liability, where practicable, an estimate of its financial effect.