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Comptroller General
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Technical Director
Financial Accounting Standards Board
File Reference No. 1235-001
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Subject: Invitation to Comment: *Selected Issues Relating to Assets and Liabilities with Uncertainties*

Dear Director:

The U.S. Government Accountability Office has reviewed the Financial Accounting Standards Board (FASB) Invitation to Comment: *Selected Issues Relating to Assets and Liabilities with Uncertainties* (ITC). We are pleased to provide our comments on these very important issues. The ITC was prepared in connection with the FASB's joint project with the International Accounting Standards Board (IASB) to develop a converged and improved conceptual framework. We support the FASB's efforts to seek convergence with the IASB.

In summary, we are concerned about whether the changes proposed in the ITC would result in improved financial reporting and reliable liability estimates. Under the proposed changes, estimates for non-financial liabilities would include estimates for events that are unlikely to occur, and the measurement of the liabilities could be based on highly subjective and uncertain information. Under current FASB standards, many of these estimates would result in disclosure rather than accrual. Consequently, we are concerned that the proposed changes could result in increased volatility in the liability estimates, distorted earnings, and increased susceptibility to earnings management. In addition, we believe that the auditor's ability to audit the estimated liabilities under this proposal could be significantly impaired due to the increased uncertainty of occurrence and the complexities added to the measurement of the liabilities. However, FASB could consider certain other actions to provide additional relevant information to financial statement users about contingent liabilities. These matters are discussed in more detail below.

First, we have serious concerns about the proposed basis for recognition of estimated liabilities. The proposed changes would remove probability from the recognition criteria for liabilities, resulting in the recognition of liabilities that, under current standards, would be considered reasonably possible or remote and therefore would not be recognized. We question the value of recognizing liabilities arising from events that are unlikely to occur, which would be required by the ITC. If, in fact, the events did not occur, the overstated liabilities would be later reduced and income recognized by the entity.

Second, we have concerns about the proposed basis of measurement. The proposed changes call for measurement of liabilities at the amount an entity would expect to pay to settle or transfer the stand-ready obligation to another entity, or at their expected value, rather than at the most likely outcome. In our view, the ITC does not demonstrate that there is a reasonable market basis to reliably measure the cost of transferring liabilities to a third party. Even if a market cost could be established, it would seem to necessarily include a risk and profit premium that, if the entity settled the obligation rather than transferring it, would not be incurred by the entity. Also, we believe that in many instances, particularly when relevant historical experience is limited, adoption of the proposed measurement approach could result in less reliable liability estimates and significant volatility in such estimates. Further, because expected values may not reasonably approximate any of the likely outcomes, significant changes in estimates could be required if the likely outcomes occurred. These potential shortcomings could negatively impact the measurement of liabilities recognized under the current standards. For example, changing the basis for measuring insurance liabilities from most likely outcomes to expected values could result in increased variations between actual and recorded liabilities.

Also, we believe that adoption of the proposed changes could have negative effects on the results of litigation. Under the proposed changes, the entity would accrue an estimate of the expected value of the litigation, which can often be based on tentative or preliminary information. Recognition of liabilities that are not probable under current standards, including frivolous lawsuits, might be used by plaintiffs as evidence of management's acknowledgement or admission of liability or damages. Another practical consideration is the ability to obtain sufficient information to develop reliable liability estimates for litigation that is not considered probable under current standards. We envision potential difficulties in obtaining such information from legal counsel for all threatened and actual litigation, particularly litigation in its early stages.

The current standard has provided a reasonable balance between relevance and reliability. We believe that the ITC does not adequately demonstrate that the current model is "broken" or that the proposed treatment would materially improve the overall quality of financial reporting. We believe that it is acceptable to have differences in the basis of accounting for certain other liabilities, such as for restructuring costs, asset retirement obligations, and costs associated with exit or disposal activities, which require fair value accounting. In these circumstances, it seems that only measurement of the liability is at issue, not the possible existence of a stand-ready obligation.

Finally, we believe that significant effort and additional costs would be required to implement the changes proposed by the ITC due to the increase in the number of liabilities that would result, the need to update the liability estimates for each reporting period (e.g., annually, quarterly), and the significant implementation costs for such a dramatic change. In our view, the added costs to implement the proposed changes would be significant to the federal government because there are a number of very large government entities that follow private-sector standards. We believe that the ITC does not provide adequate support for the cost-benefit of adopting the proposal, given the expected increased costs.

However, we do support efforts by the FASB to provide additional relevant information about contingent liabilities. In this context, the FASB could consider other actions, including:

- Clarifying the definition of probable to mean "more likely than not" to be more consistent with current IASB and FASAB standards.
- Encouraging the use of expected values for "probable" contingent liabilities when it would result in a reliable estimate.
- Requiring more disclosure about "reasonably possible" contingent liabilities.
- Requiring more disclosure of the uncertainty associated with contingent liabilities.

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We appreciate the opportunity to express our views and would be pleased to further discuss our comments with you at a convenient time. If I can be of further assistance, please call me at (202) 512-5500 or Robert Dacey, Chief Accountant, at (202) 512-7439.

Sincerely yours,

David M. Walker
Comptroller General
of the United States

cc: The Honorable Christopher Cox, Chairman,
U.S. Securities and Exchange Commission