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Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

RE: ASC Update Topic 405
Obligations Resulting from Joint and Several Liability Arrangements
File Reference Number: EITF-12D

Gentlemen:

The Emerging Issues Task Force should be commended for tackling the issue of certain joint and several liability arrangements for which there is no other guidance in U. S. GAAP, which has led to diversity in practice. While in some respects the issue of joint liability is similar to that of joint ownership, there seems to be significantly more guidance on accounting for jointly-owned assets¹ than for jointly-owed obligations. Whether the joint arrangement involves assets or liabilities, some accommodation must be made in the separate company financial statements of one party to the arrangement to address how the jointly owned/owed assets or liabilities should be reported by that party.

In accounting for joint and several liabilities, the EITF has decided generally against applying guarantee accounting (too hard)² or recording the entire amount of the liability gross (too draconian and not that useful) and has reached a consensus on applying the loss contingency guidance, a handy tool that can be applied to just about any liability (i.e., record the amount the entity expects to pay). I am concerned that the approach adopted in proposed ASC Subtopic 405-40, treats the recognition and measurement of a liability arising from a joint and several contractual debt arrangement among commonly controlled entities entirely as a contingency. My general view is that in joint and several contractual debt arrangements, the EITF should distinguish between the reporting obligor's own direct borrowings³ and those of other co-obligors and not subject the direct borrowings by the reporting co-obligor to the contingency guidance. I also believe it would be helpful to provide some additional guidance, similar to that provided in ASC Subtopic 410-30, on estimating the allocation method for the contingent aspects of the liabilities within the scope of the Update.

¹ Joint ownership of assets is dealt with in various ways that generally depend on the amount of control or influence the reporting party has over the jointly owned assets, i.e., consolidation, equity method or cost method.

² Also, commonly controlled entities are scoped out of initial recognition and measurement for guarantees anyway.

³ In this context, direct borrowings means funds the reporting co-obligor itself borrowed from the third party creditor under the debt arrangement and used for its own purposes.

Also, if the final version of ASC Topic 405-40 continues to provide guidance on fixed-amount joint and several contingencies, then I believe the scope should explicitly address joint and several contingent liabilities more broadly. EITF 12D's working group report implies that it is obvious that Subtopic 450-20 is the guidance to apply for contingent joint and several liabilities that are not fixed in amount. Some ASC users may find that conclusion less obvious, since the words "joint and several" do not seem to appear anywhere in the text of Subtopic 450-20. Thus, why not explicitly include such contingencies within the scope of ASC Subtopic 405-40, since it seems probable that preparers and others will look to the new Subtopic first since it does have the phrase "joint and several" in the title.

This letter also provides certain suggestions on modifications to the proposed guidance in areas where the guidance is either unclear or seems to have unintended results.

Question 1: Do you agree with the types of obligations resulting from joint and several liability arrangements that are included in the scope of this proposed Update (that is, the total amount under the arrangement is fixed at the reporting date and not otherwise covered by existing U.S. GAAP)? Are there other forms of joint and several liability arrangements that should be included in the scope of this proposed Update? If certain arrangements should be excluded or included, please explain why.

As was discussed in the issues summaries for EITF Issue 12D on joint and several liabilities, the scope of the proposed Update to ASC Topic 405 seems to combine non-like items. The liabilities included within the scope include both contractual debt arrangements as well as other fixed amount liabilities, such as, settled litigation or judicial rulings⁴, i.e., contingencies for which the total amount has become fixed. Normally these two types of liabilities take quite distinct paths to arriving on the balance sheet. As indicated in the EITF issues summaries, there is no uncertainty about the total amount of the liability for a contractual debt arrangement. Also, there may be little uncertainty about the intended allocation of the liability among the co-obligors. On the other hand, prior to the date when the total amount of a contingent liability becomes fixed, there is uncertainty regarding amount of the contingent liability. Further, the contingency has been subject to the contingency guidance in ASC Subtopic 450-20 since the date it was first identified as a possible claim. As discussed further below, even though the total amount of a contingent liability has become fixed, there may still be significant uncertainty regarding how the liability will be allocated among the co-obligors given that co-participation in the obligation has likely arisen from force of law rather than from a contractual co-borrowing arrangement. Further, when the liability arises from action of law the co-obligors are more likely to be unrelated parties.

These differences in circumstances associated with the liabilities suggest that users may be better served by changing the scope and/or changing the proposed accounting guidance to better reflect the differences in the nature of the arrangements and the co-obligors. If the final guidance continues to include in its scope settled litigation and judicial rulings, then the EITF should consider extending the guidance of the ASC Update to all contingent joint and several liabilities

⁴ These terms are used in the manner described in the XBRL new element table as proposed in the ASC update. Settled litigation indicates a situation in which there has been an "agreement reached between parties in a pending litigation that resolves the dispute to their mutual satisfaction and occurs without judicial intervention, supervision, or approval." Judicial ruling indicates a "litigation outcome that occurs as a result of judicial intervention, supervision, or approval."

not covered by other GAAP, which are likely to be “unsettled” contingencies. Since, as mentioned above, it may not be obvious to all that ASC 450-20 is the applicable guidance in those situations, why not provide a clearer roadmap?

Question 2: Do you agree that the scope of this proposed Update should include all entities that have joint and several liability arrangements within the scope of the proposed Update, including entities that are under common control, related parties, and unrelated parties? If not, please explain why.

Including more rather than fewer entities within the scope of the proposed Update seems the better option, since the guidance likely would be applied by analogy by excluded entities in any case. The scope of Subtopic 405-40 should certainly include entities under common control and related parties, as these entities are more likely to enter into joint and several contractual debt arrangements voluntarily. As discussed further below in response to Question 3, unrelated entities are more likely to become subject to joint and several liabilities by action of law. Thus, excluding unrelated entities from the scope may lead to the exclusion of certain fixed-amount contingent liabilities from the guidance even though there is no alternative accounting guidance applicable to such entities.

Question 3: Are you aware of joint and several liability arrangements among unrelated parties? If yes, please describe such arrangements and describe why those arrangements should be included or excluded from the scope of this proposed Update.

Regarding the nature of entities that are parties to the joint and several liability arrangements that will be subject to ASC Subtopic 405-40, these entities would likely fall into two distinct groups based on the nature of the arrangement/source of the liability. One group would be associated with joint and several contractual debt arrangements voluntarily entered into. This group is likely to include related parties, including commonly controlled entities. The second group would be associated with fixed-amount contingencies and would likely include mostly unrelated parties unwillingly trapped in joint and several liability situations by action of law.⁵

Generally the words “joint and several” when appended to the word “liability” tend to strike fear into the hearts of those who may become subject to the liability because of action of law. In the U.S. the concept of joint and several liability has often been applied to torts under common law, the most well know of which arise from negligence or reckless conduct, such as is often alleged in product liability cases or accidents.⁶ Joint and several liability has also been adopted as part of legislative actions such as in the context of superfund liabilities under Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) as amended by the Superfund amendments⁷ or federal antitrust laws. When applied in the context of various contingencies, e.g., environmental or product liability, this liability is sometimes referred to as

⁵ This should not be taken to imply that the entities did not voluntarily enter into the activity/acquisition that ultimately led to the joint and several liability, but it does imply that borrowing on a joint and several basis was not the principal motive for the arrangement.

⁶ Joint and Several Liability, Wikipedia, http://en.wikipedia.org/wiki/Joint_and_several_liability.

⁷ ASC paragraph 410-30-05-(21 to22).

the “deep pocket” liability as it often results in the party with the deepest pockets bearing the brunt of the liability, regardless of where the fault lies.⁸

One might then ask, what type of entity (person) would voluntarily subject itself (himself) to a liability where one party could receive the benefits of the borrowing and another party may experience the pain of repaying it? With this possible outcome, it seems related parties, including entities under common control, are most likely to enter into such voluntary contractual debt arrangements, particularly in situations where there is a lack of explicit consideration.

There are likely valid economic reasons for joint loan arrangements among related parties. Related parties, including entities under common control, may have a higher borrowing capacity or a lower borrowing cost if they borrow as a group. And, these arrangements may also represent ways for financially weaker affiliates of stronger, commonly-controlled companies to leverage the higher credit standing of the affiliates. Thus, the arrangement may transfer benefits from a stronger company or its noncontrolling interests to weaker companies or the controlling owner by, in essence, guaranteeing the debt of other commonly controlled entities, probably without any explicit consideration. Perhaps because of their related party context, these joint and several contractual debt arrangements involving parties not consolidated by the reporting entity do not seem particularly common among public companies.

Regarding joint and several liabilities at public companies, a quick scan of hits on a SEC filing database using the phrase “joint and several liability” leads me to believe that the majority of joint and several liabilities disclosed by public companies arise from the action of environmental laws (i.e., CERCLA and Superfund and related legislation) that impose such liability on potentially responsible parties, many of which parties are likely unrelated to the registrant. However, such liabilities would be outside the scope of Subtopic 405-40 even when the amount becomes fixed, since these liabilities are already covered by the guidance in ASC Subtopic 410-30. For public companies, there are some other fixed amount liabilities arising from contingencies other than environmental contingencies that would be in the scope of Subtopic 405-40. For example, liabilities arising from antitrust litigation are joint and several and likely involve primarily unrelated parties. Also, joint and several liability may be applied in tort settlements under common law, for example, in product liability cases, and the obligors may include unrelated parties.

Also certain forms of organization, such as partnerships, impose joint and several liability on certain partners or venturers related to liabilities of the partnership or venture.⁹ The general partners or joint venturers in these arrangements may have been unrelated parties prior to entering the asset ownership agreement and did voluntarily accept the associated joint and several liability risks when entering the asset ownership arrangements. But, once they have entered the arrangement, they become related parties at least to the jointly owned-entity. Often the accounting for these liabilities is addressed as an inherent part of the accounting for the jointly-owned assets.

⁸ Ibid.

⁹ See for example: Maine Revised Statutes Title 31: Partnerships and Associations Chapter 19: Uniform Limited Partnership Act Joint and several liability. Except as otherwise provided in subsections 2 and 3, all general partners are liable jointly and severally for all obligations of the limited partnership unless otherwise agreed by the claimant or provided by law.” At <http://www.mainelegislature.org/legis/statutes/31/title31sec1354.html>.

The EITF 12D working group members provided examples of obligations with joint and several liability or similar forms of liability including “debt, lease obligations, litigation and regulatory contingencies, income taxes, nonincome based taxes, pension liabilities, guarantees, indemnifications, hold harmless agreements, and environmental remediation liabilities.” Presumably, aside from those arising from litigation and action of law, some of these arrangements could include unrelated entities.

Question 4: Under this proposed Update, if the primary role of a reporting entity in the joint and several liability arrangement is that of a guarantor, then it should account for the obligation under Topic 460. This proposed Update includes some guidance on when the primary role is that of a guarantor. Is that guidance sufficient to distinguish between joint and several liability arrangements that should be accounted for under Topic 460 and those that should be accounted for under Subtopic 450-20? If not, please explain what additional guidance the Task Force should consider including to assist preparers in distinguishing between the two.

The guidance provided in proposed ASC paragraph 405-40-15-2 does not appear sufficient to distinguish between joint and several liability arrangements that should be accounted for as guarantees under Topic 460 and those that should be accounted for as liabilities under Subtopic 450-20. The guidance provided consists of a reference to the ASC Topic 460 on guarantees with a specific reference to the scope paragraph and the guidance on explicit consideration. While Topic 460 does provide guidance on when a contract is a guarantee, it is not particularly helpful in delineating when “the primary role of a reporting entity is that of a guarantor” (proposed ASC 405-40-15-2) in situations in which it is already acknowledged that there may be elements of a guarantee in the arrangement. Joint and several liabilities in contractual debt arrangements economically have aspects of both direct borrowings and guarantees. Should the primary role of the reporting entity be considered that of a guarantor if the entity does not anticipate borrowing any or only a minimal amount of funds directly? Or is the reporting entity’s role primarily that of a guarantor if it anticipates directly borrowing less than 50% of the funds under the arrangement? The first alternative suggested (no or minimum direct borrowings anticipated) is likely the intended conclusion but the guidance is not clear. Also, there is the question of whether the accounting would change if this anticipated role changes over time.

It is assumed that the reference to the guidance on explicit consideration for the guarantee is meant to suggest that the arrangement would *not* be considered primarily a guarantee if there is no explicit consideration. If that is the intended interpretation, that interpretation could be stated more explicitly. However, as mentioned in the basis for conclusions, since many of the contractual debt arrangements occur among related parties, it seems unlikely there will be explicit consideration.¹⁰ Further, if the joint and several liability arises from the force of law, such as antitrust law, then an explicit guarantee fee also seems unlikely. Thus, the reference to explicit consideration may address virtually a null set.

¹⁰ Also, as mentioned above, commonly controlled entities are scoped out of initial recognition and measurement for guarantees anyway.

Question 5: Do you agree that obligations resulting from joint and several liability arrangements that are included in the scope of this proposed Update should be recognized and measured as a loss contingency in accordance with Subtopic 450-20? If not, please explain why.

I do not believe that direct borrowings by the reporting co-obligor under joint and several contractual debt arrangements should be recognized and measured as contingencies. While proposed ASC paragraph 405-40-30-2 does provide some constraints on the minimum liability that could be recorded, the liability as a whole is still considered to fall under the loss contingency guidance. By following the basic loss contingency guidance of ASC Subtopic 450-20, the consensus seems to be commingling two distinct issues. One issue is determining the appropriate allocation of the gross total liability among the co-obligors without considering ability to pay and the other involves the ability to pay of the co-obligors. Explicitly separating these issues would provide clearer application guidance to preparers and others and could avoid applying contingency guidance in situations where there is little or no uncertainty.

As discussed above, for contractual debt arrangements, there is never any uncertainty about whether a liability exists or how much the liability is in total. Further, the issue about how the liability is initially¹¹ to be allocated among the parties for the contractual debt arrangement is not necessarily a “probability” issue *per se*. While a contractual debt arrangement may be joint and several, *absent a default*, determining who will repay the obligation should still be under the co-obligors’ control (or under the control of the party that controls all the co-obligors) although it may not be within the sole control of the reporting entity. Since it seems reasonable to assume that the contractual debt arrangement was voluntarily entered into by all parties, presumably the parties to the arrangement—likely related parties—have had some meeting of minds about how the debt was to be used and repaid. The agreement would likely be that the entity that directly borrows the funds is expected to repay them, since that is the norm in other lending arrangements.

As discussed in Supplement No 1 to Issues Summary No. 1, in practice, “some entities are recording less than the total amount of the obligation, such as an amount allocated, an amount corresponding to proceeds received, or the amount expected to be paid.” In some respects, as shown by the divergence in prior practice, the issue of allocation to the co-obligors (at least the initial allocation) in the contractual debt arrangement seems more of an issue of fact (i.e., what is the agreement between the parties?) or of applying a specific accounting principle (e.g., direct borrowers should record direct borrowings as liabilities) rather than an accounting estimate issue. Once the initial allocation (noncontingent) is made by the reporting entity either based on the agreement or on direct borrowings, then an additional liability (contingent) could be recorded if a fellow co-obligor is unable to repay its direct borrowings.

Such an approach, which might be called the direct borrowing principle, seems reasonable and would be representationally faithful in most joint and several contractual debt arrangements. It has the advantage of not treating a reporting entity’s own direct borrowings as a contingency. The basis for this approach would be that it reflects the norm in borrowing arrangements or, if

¹¹ By initial allocation is meant the allocation among the contractual co-borrowers prior to consideration of co-obligors ability to pay.

based on the agreement, that it reflects the agreement among the parties. Generally the party that borrows the money is the party expected to repay it; but in these arrangements the reporting party may also have to repay amounts borrowed by other co-obligors. The issue regarding ability of fellow co-obligors to pay would continue to be accounted for under the loss contingency guidance. The direct borrowing principle seems likely to yield results consistent with ASC paragraph 405-40-30-2 in the proposed Update most of the time. ASC paragraph 405-40-30-2 paragraph indicates that the liability should not be less than the greater of the amount an entity agreed to pay among co-obligors and the amount an entity expects to pay. The distinction between the two approaches is that under the ASC Update the entire liability is considered to fall under the contingencies guidance. The approach suggested here has the advantage of not applying the contingencies guidance to noncontingent aspects of contractual debt arrangements, i.e., the reporting entity's direct borrowings. GAAP does not generally default to accounting estimate treatment for jointly-owned assets, so why do so for jointly-owed liabilities?¹²

As mentioned above, for a fixed-amount contingency (particularly for liabilities where the fixed amount arises from a judicial ruling), there may be significantly more uncertainty regarding the allocation of the obligation among the co-obligors since the initial liability may have arisen by force of law and the co-obligors are likely unrelated. If the total amount of the liability has been fixed by agreement (settled litigation), presumably there has been some meeting of minds among at least some of the co-obligors that have agreed to the settlement. In this case the initial allocation could be based on the agreement (noncontingent) with necessary reallocation if any of the co-obligors do not have the financial wherewithal to pay the creditor. If the total amount has been fixed, such as in a judicial ruling, but the allocation remains open, the creditor could approach any of the co-obligors, the entire group of co-obligors, or the co-obligors may jointly approach the creditor with an allocation/payment arrangement. Thus, in this latter situation, the reporting entity may have to estimate the allocation method as well as estimating the ability to pay, i.e., uncertainty about whether all co-obligors within the allocation group have the wherewithal to pay. In this situation both the initial allocation and the financial wherewithal issue would fall under the basic contingency guidance of Subtopic 450-20.

Thus, the approach for some fixed-amount or other contingencies would then be somewhat similar to that of ASC Subtopic 410-30, which is an application of Subtopic 450-20 and does treat the allocation process as part of the estimation effort for the liability. However, there is considerably more uncertainty about what allocation method will ultimately be adopted for a specific clean-up than there would be for contractual debt obligations voluntarily entered into or even for settled litigation.¹³ Subtopic 410-30 attempts to provide some guidance how to deal with the allocation issue by reference to the superfund legislation and EPA practice and sorts the players into participating potentially responsible parties and other groups (Recalcitrant PRPs, Unproven PRPs, Parties that have not yet been identified as PRPs, Parties that are PRPs but cannot be located or have no assets (ASC 410-30-30-2)). The approach includes a presumption

¹² For jointly owned assets, GAAP requires consolidation (a gross approach applied when there is control), the equity method (although proportionate consolidation is used in some industries), or the cost method (or fair value). Thus, for jointly owned assets GAAP does in some circumstances report the assets gross (i.e., in consolidation) and there are rules for recording the joint owner's share in noncontrol circumstances (e.g., equity method or cost). These rules generally do not rely solely on an accounting estimate approach, i.e., "record what the company expects to receive."

¹³ ASC paragraph 410-30-30-5 states for environmental contingencies that "[a]n entity should determine its allocable share of the joint and several remediation liability for a site based on its estimate of the allocation method and percentage that ultimately will be used for the entire remediation effort."

that the environment liability will be shared only among the participating PRP's (ASC 410-30-30-4). The reporting entity would also consider the ability of the other participating PRP's to pay their allocable share and include in its liability, its share of amounts that the other participating PRP's may not have the financial wherewithal to pay (ASC 410-30-30-7). Recoveries, which may be from nonparticipating PRPs, insurance, the government, or other sources are treated separately and can be recorded as an asset only if realization is deemed probable (ASC 410-30-35-8).

In sum, I am concerned that the approach adopted in the proposed ASC Subtopic 405-40, treats the initial allocation issue among commonly controlled entities for contractual debt arrangements voluntarily entered into entirely as a contingency issue. It seems more appropriate for the reporting party to recognize any direct borrowings as a liability (noncontingent) with reduction only appropriate if the extinguishment guidance of ASC Section 405-20-40 is met. Applying the contingency guidance in ASC Subtopic 450-20 appears appropriate for the "ability to pay issue" for contractual debt arrangements and for joint and several contingent liabilities for which both the allocation method and ability to pay may have to be estimated. I also believe it would be helpful to provide some additional guidance, similar to that provided in ASC Subtopic 410-30, on estimating the allocation method for the contingent aspect of the liability.

Other Issues with the use of ASC Subtopic 450-20 guidance

Initial Measurement versus Subsequent Measurement

It is unclear why paragraph 405-40-30-2 (regarding the presumption that the minimum measurement of the liability is the greater of the portion of the amount an entity agreed to pay among co-obligors and the amount an entity expects to pay) is not also required to be applied on an ongoing basis. Why is the notion of the minimum liability in these circumstances relevant only to initial measurement? Surely, it should be considered on a continuing basis, yet that paragraph of Subtopic 405-40 is not referenced in the subsequent measure guidance.

Also, the language "expects to pay" in paragraph 405-40-30-2 is troubling in situations where there is no agreement among the co-obligors for sharing the liability. If there is no agreement among the co-obligors and a reporting company expects to pay nothing because it is "recalcitrant" or has no ability to pay, based on the existing language in the proposed amendment it appears possible that the reporting company may conclude it could record nothing. In the basis for conclusions for the proposed Update, the EITF indicates it wants to avoid this situation. However, if there is no agreement among the co-obligors, which may arise particularly in situations where the incurrence of the liability arises from force of law, and the entity has no financial wherewithal to pay, then the reporting entity may think it could record nothing because it "expects to pay" nothing, even though an objective allocation among the co-obligors would suggest it has a liability. Admittedly, one normally would not expect such a conclusion under ASC Subtopic 450-20 contingency guidance, but the "expects to pay" language in ASC Subtopic 405-40 at least raises the specter of this outcome.

Is all of Subtopic 450-20 to be applied?

The reference in paragraph 405-40-30-1 of the proposed amendments to ASC Subtopic 450-20 could result in some confusion as it is not entirely clear how the guidance in Subtopic 450-20 is intended to be applied to some liabilities within the scope of Subtopic 405-40 or how the guidance of the two subtopics is intended to interact. For example, loss contingencies typically

are not discounted. The relevant guidance often cited for discounting a contingent liability is paragraph 410-30-35-12 on environmental liabilities. If the particular liability to be subjected to the Subtopic 450-20 provisions is a contractual debt instrument with a bank, for example, would the amount the company “expects to pay” be the amount gross or net of the interest factor? There is no guidance in Subtopic 450-20 that addresses this issue or discounting generally.

Also, how is the guidance in paragraph 405-40-30-2 on recording the higher of the agreed upon amount and the amount the company expects to pay intended to interact with the guidance in paragraph 450-20-30-01 on range estimates? Presumably, if the guidance in the two subtopics is combined, this means the lower end of the range should never be considered to fall below the agreed upon amount, if there is an agreement among the parties.

Net Estimate versus Recording Recoveries Gross

Another issue with failing to address the allocation issue separately in ASC Subtopic 405-40 is the situation of what one might call “recalcitrant” co-obligors. This term is used but not defined in ASC paragraph 410-30-30-2. As defined in the Merriam-Webster dictionary, recalcitrant means “obstinately defiant of authority or restraint” or “difficult to manage or operate.”¹⁴ This condition may be far more common among co-obligors for liabilities that arise from the force of law, particularly from judicial rulings, than for contractual debt arrangements. What if the reporting co-obligor expects ultimately to have to “pay” only its “fair share” but achieving the net obligation involves having to sue financially able but philosophically unwilling co-obligors to collect their allocable shares? Under the guidance of recording the higher of the agreed upon amount and the amount the entity expects to pay, if there were no agreement among the parties, depending on how the phrase “expects to pay” is interpreted, it seems the company might be able to record the net amount it expects to pay as the liability, even though the company may have to sue another co-obligor to achieve that net result.

It may not be the EITF’s intent to permit “net” presentation in these circumstances, but the guidance does not make it clear whether the amount the company “expects to pay” is a gross or net concept, thus seeming to allow a probable recovery to be offset against a probable obligation, even though achieving the net amount may involve suing other co-obligors. For environmental liabilities, there is a caveat that if a “claim is the subject of litigation, a rebuttable presumption exists that realization of the claim is not probable” (ASC 410-30-35-9). Since the guidance in proposed Subtopic 405-40 does not distinguish the “recalcitrant” from other co-obligors, it appears that even if the reporting party may have to sue to recover, it is still possible to interpret the guidance to allow reporting the liability net of such a recovery, if the reporting entity believes recovery is probable even in the face of litigation. ASC Subtopic 450-20 does not contain guidance stating that probable recoveries should not be netted against losses or that there is a presumption that a recovery is not probable if it is subject to litigation, as is found in ASC Subtopic 410-30.

Extinguishment

By including contractual debt instruments in the measurement guidance for contingencies (Subtopic 450-20), the proposed ASC Update does not seem to fully consider how this might impact applying the debt extinguishment guidance to such instruments. Under the contingency

¹⁴ [Http://www.merriam-webster.com/](http://www.merriam-webster.com/).

guidance in Subtopic 450-20, if it is considered a change in estimate, a company may raise or lower the amount of the joint and several liability or even remove the entire liability in a manner similar to an extinguishment without having to meet the criteria for extinguishment accounting in ASC Section 405-20-40.

By moving the accounting for joint and several liabilities entirely into the contingencies guidance, the proposed Update raises concerns that in a related party scenario, an obligation to a third party, e.g., a bank, could be transferred among related parties without the reporting party having to meet the extinguishment criteria of Paragraph 405-20-40-1. This could occur since the allocation among the co-obligors is treated as being an estimate and any change in allocation can presumably be treated as a change in estimate without the co-obligor having to pay the creditor or being released (judicially or by the creditor) from being a primary obligor. In the case of a joint and several contractual debt arrangement, the co-borrower whose obligation is being reduced, for example, by an intercompany transfer of the liability to another co-obligor has not repaid the third party creditor and still remains a primary obligor on the obligation. This “estimation” process could be used to “window dress” the balance sheet in the separate company financial statements of individual co-obligors. ASC paragraph 405-20-50-1 does provide for disclosure in any period where the measurement changes significantly. However, unless the extinguishment guidance of paragraph 405-20-40-1 is amended to allow extinguishments when borrowers merely agree among themselves to transfer obligations without involving the creditor, direct borrowings by a co-obligor would not seem to meet the criteria for extinguishment in intercompany transfer situations in which the original direct borrower remains a primary obligor.

Other Issues

Given that the population of liabilities included will include joint and several related party contractual debt arrangements, the EITF may want to include a section under 405-40 for relationships to reference other relevant topics within the codification. For example, reference could be made to ASC Topic 850 on related parties and to paragraph 470-50-40-2 for guidance on debt extinguishment transactions between related entities that may be in essence capital transactions.

Question 6: Do you agree with the disclosure requirements for obligations resulting from joint and several liability arrangements that would be included in the scope of this proposed Update? If not, please explain why.

While paragraph 405-40-50-1 of the proposed amendment requires disclosure of “the nature of the arrangement, including how the liability arose, the relationship with other co-obligors, and the terms and conditions of the arrangement,” it is not clear whether this is intended to require disclosure of how the co-obligors have agreed to allocate the liability among themselves, if there is such an agreement. This appears to be an important factor in determining the amount of the liability yet it is not clear that this “allocation” method is required to be disclosed.

Further, if the joint and several liability is a contractual debt arrangement, such as a bank debt, it is not clear how these disclosures are intended to interact with other required disclosures related to long-term debt, such as five-year maturities disclosures in ASC paragraph 470-10-50-1. That is, to the extent that obligation is to a third party, it is presumed that the reporting entity is required to include its “share” of the obligation in the five year maturities disclosures. Perhaps a

footnote to such normal debt disclosures is warranted to explain any uncertainties arising from the joint and several obligation arrangements.

If you have any questions regarding these comments, please feel free to contact me.

Sincerely yours,

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