

AU Section 337B

Exhibit I—Excerpts From Financial Accounting Standards Board Accounting Standards Codification 450, Contingencies

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Overall

Overview and Background

General

450-10-05-4. The Contingencies Topic establishes standards of financial accounting and reporting for loss contingencies and gain contingencies, including standards for disclosures.

450-10-05-5. Resolution of the uncertainty may confirm any of the following:

- a. The acquisition of an asset
- b. The reduction of a liability
- c. The loss or impairment of an asset
- d. The incurrence of a liability.

450-10-05-6. Not all uncertainties inherent in the accounting process give rise to contingencies.¹ Estimates are required in financial statements for many ongoing and recurring activities of an entity. The mere fact that an estimate is involved does not of itself constitute the type of uncertainty referred to in the definition of a *loss contingency*² or a *gain contingency*.³ Several examples of situations that are not contingencies are included in Section 450-10-55.

¹ According to the Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) glossary, a *contingency* is "an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss (loss contingency) to an entity that will ultimately be resolved when one or more future events occur or fail to occur."

² According to the FASB ASC glossary, a *gain contingency* is "an existing condition, situation, or set of circumstances involving uncertainty as to possible gain to an entity that will ultimately be resolved when one or more future events occur or fail to occur."

³ According to the FASB ASC glossary, a *loss contingency* is "an existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur. The term loss is used for convenience to include many charges against income that are commonly referred to as expenses and others that are commonly referred to as losses."

Loss Contingencies

Recognition

General

General Rule

450-20-25-1. When a loss contingency exists, the likelihood that the future event or events will confirm the loss or impairment of an asset or the incurrence of a liability can range from *probable*⁴ to *remote*.⁵ As indicated in the definition of contingency the term *loss* is used for convenience to include many charges against income that are commonly referred to as expenses and others that are commonly referred to as losses. The Contingencies Topic uses the terms *probable*, *reasonably possible*,⁶ and *remote* to identify three areas within that range.

450-20-25-2. An estimated loss from a loss contingency shall be accrued by a charge to income if both of the following conditions are met:

- a. Information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. Date of the financial statements means the end of the most recent accounting period for which financial statements are being presented. It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss.
- b. The amount of loss can be reasonably estimated.

The purpose of those conditions is to require accrual of losses when they are reasonably estimable and relate to the current or a prior period. Paragraphs 450-20-55-1 through 55-17 and Examples 1–2 (see paragraphs 450-20-55-18 through 55-35) illustrate the application of the conditions. As discussed in paragraph 450-20-50-5, disclosure is preferable to accrual when a reasonable estimate of loss cannot be made. Further, even losses that are reasonably estimable shall not be accrued if it is not probable that an asset has been impaired or a liability has been incurred at the date of an entity's financial statements because those losses relate to a future period rather than the current or a prior period. Attribution of a loss to events or activities of the current or prior periods is an element of asset impairment or liability incurrence.

Disclosure

General

Accruals for Loss Contingencies

450-20-50-1. Disclosure of the nature of an accrual made pursuant to the provisions of paragraph 450-20-25-2, and in some circumstances the amount accrued, may be necessary for the financial statements not to be misleading. Terminology used shall be descriptive of the nature of the accrual, such as estimated liability or liability of an estimated amount. The term *reserve* shall not be used for an accrual made pursuant to paragraph 450-20-25-2; that term is limited to

⁴ According to the FASB ASC glossary, *probable* is "the future event or events are likely to occur."

⁵ According to the FASB ASC glossary, *remote* is "the chance of the future event or events occurring is slight."

⁶ According to the FASB ASC glossary, *reasonably possible* is "the chance of the future event or events occurring is more than remote but less than likely."

an amount of unidentified or unsegregated assets held or retained for a specific purpose. Examples 1 (see paragraph 450-20-55-18) and 2, Cases A, B, and D (see paragraphs 450-20-55-23, 450-20-55-27, and 450-20-55-32) illustrate the application of these disclosure standards.

450-20-50-2. If the criteria in paragraph 275-10-50-8 are met, paragraph 275-10-50-9 requires disclosure of an indication that it is at least reasonably possible that a change in an entity's estimate of its probable liability could occur in the near term. Example 3 (see paragraph 450-20-55-36) illustrates this disclosure for an entity involved in litigation.

Unrecognized Contingencies

450-20-50-3. Disclosure of the contingency shall be made if there is at least a reasonable possibility that a loss or an additional loss may have been incurred and either of the following conditions exists:

- a.* An accrual is not made for a loss contingency because any of the conditions in paragraph 450-20-25-2 are not met.
- b.* An exposure to loss exists in excess of the amount accrued pursuant to the provisions of paragraph 450-20-30-1.

Examples 1–3 (see paragraphs 450-20-55-18 through 55-37) illustrate the application of these disclosure standards.

450-20-50-4. The disclosure in the preceding paragraph shall include both of the following:

- a.* The nature of the contingency
- b.* An estimate of the possible loss or range of loss or a statement that such an estimate cannot be made.

450-20-50-5. Disclosure is preferable to accrual when a reasonable estimate of loss cannot be made. For example, disclosure shall be made of any loss contingency that meets the condition in paragraph 450-20-25-2(a) but that is not accrued because the amount of loss cannot be reasonably estimated (the condition in paragraph 450-20-25-2(b)). Disclosure also shall be made of some loss contingencies that do not meet the condition in paragraph 450-20-25-2(a)—namely, those contingencies for which there is a reasonable possibility that a loss may have been incurred even though information may not indicate that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements.

450-20-50-6. Disclosure is not required of a loss contingency involving an unasserted claim or assessment if there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment unless both of the following conditions are met:

- a.* It is considered probable that a claim will be asserted.
- b.* There is a reasonable possibility that the outcome will be unfavorable.

450-20-50-7. Disclosure of noninsured or underinsured risks is not required by this Subtopic. However, disclosure in appropriate circumstances is not discouraged.

450-20-50-8. No disclosure about general or unspecified business risks is required by this Subtopic, however, Topic 275 requires disclosure of certain business risks.

Losses Arising After the Date of the Financial Statements

450-20-50-9. Disclosure of a loss, or a loss contingency, arising after the date of an entity's financial statements but before those financial statements are

issued, as described in paragraphs 450-20-25-6 through 25-7, may be necessary to keep the financial statements from being misleading if an accrual is not required. If disclosure is deemed necessary, the financial statements shall include both of the following:

- a. The nature of the loss or loss contingency
- b. An estimate of the amount or range of loss or possible loss or a statement that such an estimate cannot be made.

450-20-50-10. Occasionally, in the case of a loss arising after the date of the financial statements if the amount of asset impairment or liability incurrence can be reasonably estimated, disclosure may best be made by supplementing the historical financial statements with pro forma financial data giving effect to the loss as if it had occurred at the date of the financial statements. It may be desirable to present pro forma statements, usually a balance sheet only, in columnar form on the face of the historical financial statements.

Implementation Guidance and Illustrations

General

Implementation Guidance

Litigation, Claims, and Assessments

450-20-55-10. The following factors should be considered in determining whether accrual and/or disclosure is required with respect to pending or threatened litigation and actual or possible claims and assessments:

- a. The period in which the underlying cause (that is, the cause for action) of the pending or threatened litigation or of the actual or possible claim or assessment occurred
- b. The degree of probability of an unfavorable outcome
- c. The ability to make a reasonable estimate of the amount of loss.

Examples 1 through 2 (see paragraphs 450-20-55-18 through 55-35) illustrate the consideration of these factors in determining whether to accrue or disclose litigation.

Losses Arising Before the Date of the Financial Statements

450-20-55-11. Accrual may be appropriate for litigation, claims, or assessments whose underlying cause is an event occurring on or before the date of an entity's financial statements even if the entity does not become aware of the existence or possibility of the lawsuit, claim, or assessment until after the date of the financial statements. If those financial statements have not been issued, accrual of a loss related to the litigation, claim, or assessment would be required if the probability of loss is such that the condition in paragraph 450-20-25-2(a) is met and the amount of loss can be reasonably estimated.

Assessing Probability of the Incurrence of a Loss

450-20-55-12. If the underlying cause of the litigation, claim, or assessment is an event occurring before the date of an entity's financial statements, the probability of an outcome unfavorable to the entity must be assessed to determine whether the condition in paragraph 450-20-25-2(a) is met. Among the factors that should be considered are the following:

- a. The nature of the litigation, claim, or assessment
- b. The progress of the case (including progress after the date of the financial statements but before those statements are issued)

- c. The opinions or views of legal counsel and other advisers, although, the fact that legal counsel is unable to express an opinion that the outcome will be favorable to the entity should not necessarily be interpreted to mean that the condition in paragraph 450-20-25-2(a) is met
- d. The experience of the entity in similar cases
- e. The experience of other entities
- f. Any decision of the entity's management as to how the entity intends to respond to the lawsuit, claim, or assessment (for example, a decision to contest the case vigorously or a decision to seek an out-of-court settlement).

450-20-55-13. The filing of a suit or formal assertion of a claim or assessment does not automatically indicate that accrual of a loss may be appropriate. The degree of probability of an unfavorable outcome must be assessed. The condition in paragraph 450-20-25-2(a) would be met if an unfavorable outcome is determined to be probable. Accrual would be inappropriate, but disclosure would be required, if an unfavorable outcome is determined to be reasonably possible but not probable, or if the amount of loss cannot be reasonably estimated.

450-20-55-14. With respect to unasserted claims and assessments, an entity must determine the degree of probability that a suit may be filed or a claim or assessment may be asserted and the possibility of an unfavorable outcome. If an unfavorable outcome is probable and the amount of loss can be reasonably estimated, accrual of a loss is required by paragraph 450-20-25-2. For example:

- a. A catastrophe, accident, or other similar physical occurrence predictably engenders claims for redress, and in such circumstances their assertion may be probable.
- b. An investigation of an entity by a governmental agency, if enforcement proceedings have been or are likely to be instituted, is often followed by private claims for redress, and the probability of their assertion and the possibility of loss should be considered in each case.
- c. An entity may believe there is a possibility that it has infringed on another entity's patent rights, but the entity owning the patent rights has not indicated an intention to take any action and has not even indicated an awareness of the possible infringement. In that case, a judgment must first be made as to whether the assertion of a claim is probable.

450-20-55-15. If the judgment is that assertion is not probable, no accrual or disclosure would be required. On the other hand, if the judgment is that assertion is probable, then a second judgment must be made as to the degree of probability of an unfavorable outcome. The disclosures described in paragraphs 450-20-50-3 through 50-8 would be required in either of the following circumstances:

- a. An unfavorable outcome is probable but the amount of loss cannot be reasonably estimated.
- b. An unfavorable outcome is reasonably possible but not probable.

Assessing Whether a Loss is Reasonably Estimable

450-20-55-16. As a condition for accrual of a loss contingency, the condition in paragraph 450-20-25-2(b) requires that the amount of loss can be reasonably estimated. In some cases, it may be determined that a loss was incurred because an unfavorable outcome of the litigation, claim, or assessment is probable (thus satisfying the condition in paragraph 450-20-25-2(a)), but the range of possible loss is wide. Examples 1 and 3 (see paragraphs 450-20-55-18 and 450-20-55-36)

illustrate the application of the standards in this Subtopic when the range of possible loss is wide.

Losses Arising After the Date of the Financial Statements

450-20-55-17. As a condition for accrual of a loss contingency, the condition in paragraph 450-20-25-2(a) requires that information available prior to the issuance of financial statements indicate that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. Accordingly, accrual would clearly be inappropriate for litigation, claims, or assessments whose underlying cause is an event or condition occurring after the date of financial statements but before those financial statements are issued. For example, an entity would not accrue a suit for damages alleged to have been suffered as a result of an accident that occurred after the date of the financial statements. However, disclosure may be required by paragraphs 450-20-50-9 through 50-10.

Illustrations

Example 1: Litigation Open to Considerable Interpretation

450-20-55-18. An entity may be litigating a dispute with another party. In preparation for the trial, it may determine that, based on recent developments involving one aspect of the litigation, it is probable that it will have to pay \$2 million to settle the litigation. Another aspect of the litigation may, however, be open to considerable interpretation, and depending on the interpretation by the court the entity may have to pay an additional \$8 million over and above the \$2 million.

450-20-55-19. In that case, paragraph 450-20-25-2 requires accrual of the \$2 million if that is considered a reasonable estimate of the loss.

450-20-55-20. Paragraphs 450-20-50-1 through 50-2 require disclosure of the nature of the accrual, and depending on the circumstances, may require disclosure of the \$2 million that was accrued.

450-20-55-21. Paragraphs 450-20-50-3 through 50-8 require disclosure of the additional exposure to loss if there is a reasonable possibility that the additional amounts will be paid.

[Revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]
