THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

May 18, 2010

Via email: commentletters@iasb.org

International Accounting Standards Board
1st Flr., 30 Cannon Street
London C4M 6XH
United Kingdom

Dear Colleagues:

Re: Measurement of Liabilities in IAS 37 (ED/2010/1)

We are writing on behalf of the Canadian Bar Association (**CBA**)[1] in response to the International Accounting Standards Board's invitation to comment on Exposure Draft ED/2010/1 published January 5, 2010 (**Exposure Draft**) setting out proposed measurement guidance for a new International Financial Reporting Standard to replace International Accounting Standard 37.

We have considered the questions raised in the Exposure Draft from our perspective as legal counsel to clients who are the preparers of financial statements. Our purpose, like yours, is to ensure that the final standard best serves the public interest by providing informative yet reliable financial reporting on liabilities while not compromising outcome of litigation involving the preparer. As lawyers, we also have a professional duty to protect the confidentiality and privilege of lawyer-client communications. The CBA welcomes the opportunity to make these comments.

For purposes of this comment letter, we have reviewed:

- the Exposure Draft;
- the IASB document entitled "Snapshot": IAS 37 Replacement; and
- the Working Draft dated 19 February 2010 of International Financial Reporting Standard [X] – Liabilities (**Working Draft**).

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1 The Canadian Bar Association is a national association representing 37,000 members, including lawyers, notaries, law teachers, students and judges across Canada. The CBA's primary objectives include improvement in the law and the administration of justice.

In advance of the adoption of IFRS in Canada for public enterprises commencing in January 2011, CBA is participating in a task force with representatives of CBA, the Canadian Institute of Chartered Accountants (**CICA**) and the Auditing and Assurance Standards Board of Canada (**AASB**) to consider changes to the CICA/CBA Joint Policy Statement on Audit Enquiries (**JPS**). The JPS sets out the basis for communications with Canadian law firms regarding claims and possible claims in connection with the preparation of financial statements.

Our comments are limited to Question 1 of the Exposure Draft. We conclude that the proposed changes to IAS 37 are problematic for two reasons:

- they mistakenly presume that outcomes can be reliably predicted in legal proceedings, which may place a costly and time-consuming burden on reporting companies and may result in misleading disclosure about legal proceedings; and
- they may lead to inappropriate disclosure about legal proceedings that may prejudice the outcome of those proceedings.

Question 1 – Overall Requirements

The proposed measurement requirements are set out in paragraph 36A-36F. Paragraphs BC2-BC11 of the Basis for Conclusion explains the Board's reasons for these proposals.

Do you support the requirements proposed in paragraphs 36A-36F? If not, with which paragraphs do you disagree and why?

Comments

Our comments focus on the measurement of liabilities associated with legal proceedings. These liabilities are typically not capable of transfer to a third party and therefore subparagraph 36B(c) has little or no application.

Paragraph 36B requires the entity to measure the liability by, in effect, determining the lowest of (i) the present value of the cost to the entity of fulfilling the relevant obligation (i.e. satisfying the litigation claim) measured in accordance with Appendix B or (ii) cancelling (i.e. settling) the legal claim.

Paragraphs B2 and B3 of Appendix B envisage that, in cases of uncertainty, an entity will identify a range of possible outcomes and then assess the probability of each outcome to arrive at an estimate of expected present value of outflows. While this approach may be appropriate for certain forms of potential liabilities such as warranty claims, we believe it has little application in the context of most material litigation.

The difficulty in reliably predicting outcomes in the litigation context results from the nature and length of the process. There are several stages to the process and uncertainty at each stage. The Canadian process is broadly similar to procedures followed in other jurisdictions. It begins with pleadings of the parties, continues with production of documents, discovery, filing and examination of affidavits and pre-trial motions, and proceeds to trial and possibly to appeal. At each stage, the issues may encompass not only liability, but interdependent issues such as jurisdiction and appropriate remedies. Even in the best situation, assuming fairly reliable estimates of the probabilities of outcomes for each issue can be made, the compounded uncertainties are likely to make the overall estimate invalid. Of course, as recognized implicitly in paragraph 36E, the uncertainty diminishes as each stage passes. But this takes some time, in many cases years.

In fact, the "best situation" rarely exists. The pool of background data and experience from which to assess the outcome in respect of a particular litigation may be very small and is often inversely proportional to the materiality of the litigation to the entity concerned. (In this regard, exposure due to litigation is not comparable to a warranty exposure for which there is often sufficient historical data on which to base a reliable estimate.) Each case depends on its own facts. Legal precedents determine the outcome of a case only if the facts are indistinguishable. In addition, for some cases there is no legal precedent. The facts of a case ultimately have to be established at trial by a judge or

a jury. Although the evidence of each party is disclosed in discovery, some key facts may not be determined until trial, for example facts to be established from the testimony of witnesses. The performance of witnesses under examination and cross-examination is always subject to some uncertainty. This uncertainty cannot be quantified.

While Paragraph BC15(c) states *"There may be some, extremely rare, situations in which the outcome of a liability – possibly a major unprecedented lawsuit – is so uncertain that the expected value (and probably also the likely outcome) cannot be measured reliably"* and that both paragraph 26 of IAS 37 and paragraph 24 of the Exposure Draft seek to accommodate this, we question the Board's characterization of these circumstances as "extremely rare". In our view, they are in fact commonplace and inevitable by virtue of the realities of the legal system. To treat them otherwise would seem in many cases to force reporting entities into speculative exercises involving their legal advisers and lead to unproductive, costly and potentially misleading probability assessments.

We also believe that requiring counsel to provide definitive probability assessments regarding a multitude of possible outcomes prior to the actual resolution of a legal proceeding by the court or regulatory body is unreasonable.

Recommendation:

The CBA recommends that the Board to reconsider use of the term "extremely rare" in paragraph 24 of the Working Draft.

Disclosure of the amount that an entity would rationally pay to be relieved of an obligation is also problematic in a litigation context. Revealing the amount of a provision in respect of a recognized liability may be prejudicial to the case in question because it may reveal details about the case which should not be made public.

Paragraph 46 of the Exposure Draft indicates that recognized liabilities might be grouped together and disclosed in aggregate. Arguably, liabilities relating to litigation or regulatory proceedings could form a group. While grouping several claims may reduce the prejudicial effects of disclosure to an entity that has many claims, grouping is of little use to an entity with one or two claims or with one particular large claim.

Paragraph 55 of the Working Draft provides an exemption from disclosure requirements in paragraphs 44-54 of the Working Draft in those "extremely rare" circumstances when it is determined that disclosure of the amount would have a significant adverse effect on the resolution of the litigation. In our experience, this disclosure will frequently, not rarely, have significant adverse effects on the resolution of the litigation. Disclosure of an amount will make it apparent to the opposition that the party disclosing it (i) expects to lose the pending litigation, and (ii) believes that its loss will approximately the disclosed amount.

Release of this information will influence the course of the litigation by making it extremely difficult to negotiate a more favourable settlement. Disclosure will encourage an adversary to continue the litigation and to seek a higher award than would have otherwise been sought. Since settlement negotiations depend on the confidentiality of each party's estimate of its chances of success, disclosures of these estimates will impede the official resolution of legal actions.

Regulatory proceedings also may be similarly influenced by disclosure of the proceedings as contingencies in financial statements. Disclosure of the proceedings and of an amount or range of the fine or penalty estimated to be levied as a result thereof may influence how the regulator prosecutes the entity and the regulator's willingness to negotiate pleas with the entity.

Further, any mandatory disclosure requirement will place pressure on management to estimate lower liabilities in respect of litigation, in order to strengthen its bargaining position and settlement negotiations. This consequence is clearly undesirable as it potentially conveys misleading information to financial statement users.

Recommendation:

The CBA recommends that the Board reconsider use of the term "extremely rare" in Paragraph 55 of the Working Draft.

We urge the IASB to reconsider its approach to recognizing liabilities arising from litigation in IAS 37.

Yours truly,

(Original signed by Tamra l. Thomson for Carmele N. Peter)

Carmele N. Peter
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Joint Policy Statement on Audit Enquiries

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