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As you all may have known by known, our company (M Inc.) has been locked in a long-standing litigation over a specific patent infringement matter. In the end, after an initial hearing and an appeal hearing at the Court of Appeals, the decision turned in favor of M Inc. Nonetheless, even though the amount that M did not lose the amount it was set to lose if the decision had gone in favor of W INC., this trial still cost the company considerable amount. But then again, regardless of whether the expenditures related to the trial are considerable or not, it has still impacted on our financial recording and records. This memo is to explain in what ways this trial has affected M Inc.'s financial statement, including liability related to the financial years within the period of the trial, balance sheet and income statement overall, among other related elements.

- In May 2007, W filed patent infringement claim against M.
- For the year ended December 31, 2007, M Inc. management decided that a loss for this matter was likely. The management then estimated the loss related to a likely compensation within the range of \$15 million to \$20 million, \$17 million being the most likely amount of loss.
- A jury trial was held in September 2009 and reached a verdict on September 24, 2009, the judgment ordering in favor of W. M was required to pay W \$18. 5 million.
- M fought back, filing a Notice of Appeal with the Court of Appeals in November 2009.
- The Court of Appeals made its verdict in December 2010 in which it ruled in favor of M's appeal, thereby reversing the earlier ruling made by the lower court. In other words, the Court of Appeals overturned the jury's \$18. 5

million pay-up verdict against M.

- W did not stop there. On January 6, 2011, it went on to file a petition for a re-hearing (aiming to have the ruling by Court of Appeals reversed) which was also held before the same panel of appellate judges.

- The appellate judges made their final judgment on February 10, 2011, and by it declining the petition for a re-hearing.

- On February 28, 2011, upon discussions with in-house legal counsel, M Inc. management determined this matter closed.

Finally, we look at the specific ways in which this trial has affected M's financial statement and what implications this has on the balance sheet and the overall income statement, among others. First, the final liability of the company (M Inc.) is dependent on the outcome of the court proceedings. In this case, as of the financial year ended December 2009, M faced a determined loss of \$18.5 million as pay-up to W Inc. Add this to trial expenses, the liability was higher. At this stage, M had to make two journal entries. 'Debit lawsuit expense' would account for expenses in the trial process. 'Credit estimated lawsuit liability' (related the overall loss after paying up for the patent infringement, which at this stage was about a maximum of \$20 million, \$1.5 million more than the court's decision. This extra \$1.5 million would have to be accounted for). The dollar amounts would be entered in general ledger, thereby increasing both of these accounts accordingly. Indeed, the second liability (patent infringement pay-up) reduced considerably when the court of appeal reversed that decision in the second hearing. However, before the decision was made, the company would not change its journal entries. Again, when W filed a petition for re-

hearing in January 2006, M might have considered a potential loss. But this time, M would probably wait to see if the court would permit a re-hearing before making any changes to its journals.

Secondly, these journal entries would also affect M's income statement and the balance sheet. Particularly, the lawsuit expense would be included in the M's overall income statement and constitute the net income calculation (Greenwald, 2006; Koprowski & Arsenault, 2010). Unlike the lawsuit liability, this did not reduce in the second trial. It had to be accounted for in the process of the first trial, which means there were separate entries for the financial years ended 31 December 2007 (however minimal) and 31 December 2008 (however minimal) and 31 December 2009 (the year of jury trial and that M filed a Notice of Appeal with the Courts of Appeal). For the second trial, a separate entry would be made for the financial year ended 31 December 2010 (the year of the appeal hearing).

Finally, the estimated lawsuit liability would be included in the balance sheet (that is, the liability section) (Greenwald, 2006; Koprowski & Arsenault, 2010). In this regard, changes would be made throughout the trial. During the first trial, M estimated the patent infringement pay-up at a maximum of \$20 million. But the court's decision of \$18.5 million means that the liability (as estimated in the financial year ending 31 December 2007) would be reduced by \$1.5 million in the financial year ending 31 December 2009). Ultimately, the regained \$18.5 million would be accounted for in the balance sheet for the year ended 31 December 2010.

## **References**

Greenwald, D. M. (2006). Corporate Governance-Transparency in Financial Reporting

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