**VISA’s LITIGATION ESCROW FUND**

***Anthony H. Catanach Jr. and J. Edward Ketz***

***Grumpy Old Accountants, January 2012***

Visa recently set aside some cash to fund future litigation payouts. This is an interesting announcement because it may portend the booking of some litigation losses not already recognized by the firm.

Specifically, Visa issued a [press release on December 23, 2011](http://www.sec.gov/Archives/edgar/data/1403161/000119312511351603/d273065dex991.htm), in which it stated that the firm:

announced it had decided to deposit $1.565 billion (the “Loss Funds”) into the litigation escrow account previously established under the Company’s retrospective responsibility plan (the “Plan”). Under the terms of the Plan, when the Company funds the litigation escrow account, the value of the Company’s Class B shares – which are held exclusively by U.S. financial institutions and their affiliates and successors – is correspondingly adjusted via a reduction in the Class B shareholders’ as-converted share count. This has the same effect on earnings per share as repurchasing the Company’s class A common stock, by reducing the as-converted class B common stock share count. The Company will make this deposit by using funds previously allocated to its current $2 billion class A repurchase program, which was announced on July 27 and October 26, 2011, and which will exhaust all funds available under that program.

We checked those two announcements. [On July 27](http://www.sec.gov/Archives/edgar/data/1403161/000119312511198906/dex991.htm), the business enterprise did announce the authorization of a new $1 billion share repurchase program. [On October 26](http://www.sec.gov/Archives/edgar/data/1403161/000119312511282026/d247231dex991.htm), Visa increased this authorization by $1 billion.

We also took a look at the [10-K for fiscal year ended September 30, 2011](http://www.sec.gov/Archives/edgar/data/1403161/000119312511315956/d218694d10k.htm#tx218694_13). We note that restricted cash, restricted for this litigation escrow account, increased from $1,866 million to $2,857 million. For fiscal 2011, the company injected cash of $1,200 million and disbursed $280 million in its American Express settlement.

Next we trotted to footnote 21, dealing with legal matters. Visa said the beginning of year 2011 balance in its litigation reserves was $697 million. The provision for settled legal matters was $7 million, reclassification of settled matters $12, and interest accretion $11. It made payments of $302, giving a balance on September 30, 2011 of $425 million.

This footnote also sketches out the details of the complaint by American Express in 2004 and the settlement reached between the corporations on November 9, 2007. Under this agreement, American Express would receive a maximum of $2.07 billion from Visa. Visa booked this loss for $1.9 billion, the present value of the future cash payments, using a rate of 4.72 percent.

Visa paid American Express $1.13 billion on March 31, 2008. It promised to pay the rest in quarterly payments of up to $70 million each quarter for the next 16 quarters, beginning April 2008. Any deficiencies in a given quarter would be added to the amount to be paid in future quarters.

What we don’t understand is the discrepancy in the liability in the latest 10-K and the announcement of how much the firm put into its escrow account. Recall the balance as of September 30, 2011 is $425 million. And the amount recently deposited in the escrow account is $1,565 million. We understand the $425 million is a present value number, but with a low interest rate and not too many quarters left in its payments, our guess is the undiscounted liability is significantly lower than the recent increment to its fund. So, what is causing the difference?

Our hypothesis is that the firm is anticipating more payments for some legal reasons that we don’t know. But if it is anticipating future disbursements, shouldn’t the enterprise be recognizing more litigation losses in its income statement?

FASB provides some guidance on accounting for loss contingencies, though this is more in the area of settled losses. The only variables are the precise cash flows and their timing. ASC 450-20-05-5 says that if the contingency is probable (the settlement clearly satisfies this criterion) and if it is reasonably estimable, then the firm should accrue the loss. If Visa can estimate how much cash it needs to add to the escrow account, clearly the amount of the litigation loss is estimable and should be accrued.

ASC 450-20-05-6, however, adds some confusion. Visa might take a fair value approach and estimate what an entity would require it to pay to assume the obligation. This gets us into the mess of valuing liabilities using a firm’s own credit risk to determine the appropriate discount rate. Still, this credit risk would have to be very high to make up the approximately $1.1 billion discrepancy between the September 30 liability balance and the additional funding.

We hope Visa explains this to us in some straight-forward language in its next 10-Q. Better yet, we hope to see an appropriate accrual that ties the accounts together.

*This essay reflects the opinion of the authors and not necessarily the opinions of The Pennsylvania State University, The American College, or Villanova University.*