C.R. BARD, INC.: WHEN SHOULD A CONTINGENT LIABILITY ARISING FROM A PRODUCT LIABILITY BE REPORTED IN THE FINANCIAL STATEMENTS?

STEVE HALL
SARAH BORCHERS
University of Nebraska at Kearney

To report or not to report? That was the question. Beginning in 2010, C.R. Bard, Inc. (Bard) was sued by a number of women who had received a surgical mesh implant that the company manufactured; the implant had subsequently led to significant medical complications. By the end of 2011, the number of lawsuits stood at 532. The company had been able to avoid reporting a loss and contingent liability for two years, but by the end of 2012, the number of lawsuits numbered 2,320 and the company had lost one of the lawsuits, with significant damages awarded to the plaintiff (C.R. Bard, Inc. 2013). Such a judgement increased the probability that the company would have to pay out for the other lawsuits that had been filed. It also increased the likelihood that others would come forward and additional lawsuits would be filed. Could Bard continue to avoid reporting a contingent liability and loss on its financial statements? If yes, how long could it continue to do so?

You are one of the accounting interns hired by Bard. To answer these questions, you need to know more about Bard, its product, the problems with its product, the lawsuits, the damages awarded, the accounting rules that govern reporting of contingent liabilities and losses, and how losses from product liability can be estimated. The CFO has tasked you with researching the issue and reporting back to her with your suggestions. Impressing the CFO could help you

The authors developed the case for class discussion rather than to illustrate either effective or ineffective handling of the situation. The case and its accompanying instructor's manual were anonymously peer reviewed and accepted by the ***Journal of Case Research and Inquiry, Vol. 8, 2023***, a publication of the Western Casewriters Association. The authors and the ***Journal of Case Research and Inquiry*** grant state and nonprofit institutions the right to access and reproduce this manuscript for educational purposes. For all other purposes, all rights are reserved to the authors. Copyright © 2023 by Steve Hall and Sarah Borchers. Contact Sarah Borchers, University of Nebraska at Kearney, 1917 W. 24th Street, Kearney, NE 68849, borcherssj@unk.edu.

land a full-time job with Bard after graduation, the company that you've had your eye on since you started college.

Bard Pharmaceuticals

Bard was a manufacturer of medical, surgical, diagnostic and patient care devices (C.R. Bard, Inc. 2013). The company was founded in 1907 by Charles Russell Bard, incorporated in 1923, went public in 1963, and first started trading on the New York Stock Exchange in 1968. Bard's 2013 10-K can be accessed here: https://www.sec.gov/Archives/edgar/data/9892/000119312513067023/d445844d10k.htm

Bard's specialties included vascular products (e.g., catheters, meshes, stents, vena cava filters, and biopsy devises), urology products (e.g., various catheters, incontinence products, and stone removal devices), oncology products (e.g., vascular access catheters and ports and ultrasound devices), and surgical specialty products (e.g., implanted grafts and fixation devices for hernia and soft tissue repair, surgical continence products for women, and surgical sealant to control bleeding) (C.R. Bard, Inc. 2013).

The Nature and Use of the Surgical Mesh

The surgical mesh was a weblike material used to repair hernias and pelvic organ prolapse. Pelvic organ prolapse was a medical condition in which the uterus, bowel, or bladder slipped down from its normal position and bulged into the vagina. The mesh was made of a non-absorbable material and remained in the body as a permanent implant (Health Service Executive 2022).

The majority of women who received the implant had good outcomes, reporting improvement in symptoms with no side effects. However, some women suffered severe complications, including general pelvic area pain, painful intercourse, pain with urination, bleeding, erosion (movement of the mesh to surrounding tissues and organs) or urinary problems (Health Service Executive 2022).

The Lawsuits

While most implants of the surgical mesh were successful and seventy percent of patients said that they were totally satisfied with the results of their surgeries, several thousand lawsuits were filed against the company. Plaintiffs claimed damages for medical expenses, loss of wages, loss of quality of life, pain and suffering, and punitive damages (C.R. Bard, Inc. 2013). Other cases might still be filed in the future. Plaintiffs argued that the problems with the bands were evident early on, and that the company failed to warn potential patients of problems that had been occurring. The company counter-argued that any problems with the bands had been fixed as they became evident, and that all lawsuits were related to bands implanted in the first two years that the product was available.

The Rule and the Theory

Financial Accounting Concepts Statement #8 defined the objective of financial reporting. The objective of general purpose financial reporting was to provide financial information about the reporting entity that was useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity (Financial Accounting Standards Board 2021).

The rule governing the reporting of contingent liabilities was found in the Codification of Accounting Standards (Financial Accounting Standards Board 2022):
https://asc.fasb.org/1943274/2147482942

Accounting Standard 450-20-25-2 stated that an estimated loss from a loss contingency should be accrued by a charge to income ***if*** both of the following conditions were met:

1. Information available before the financial statements were issued (or were available to be issued) indicated that it was probable that an asset had been impaired, or a liability had been incurred at the date of the financial statements. It was implicit in this condition that it must be probable that one or more future events would occur confirming the fact of the loss.
2. The amount of loss could be reasonably estimated.

Accounting Standard 450-20-25-5 stated that requirement should not delay accrual of a loss until only a single amount could be reasonably estimated. To the contrary, when the condition in paragraph 450-20-25-2(a) was met and information available indicated that the estimated amount of loss was within a range of amounts, it followed that some amount of loss had occurred and could be reasonably estimated. Thus, when the condition in paragraph 450-20-25-2(a) was met with respect to a particular loss contingency and the reasonable estimate of the loss was a range, the condition in paragraph 450-20-25-2(b) was met and an amount should be accrued for the loss.

It was widely understood that in practice *"probable"* was interpreted to mean about a seventy percent or greater possibility (Deloitte 2019).

First Judgement against the Firm

The first case ended in 2012 with a verdict in favor of the plaintiff, Christine Scott, and an award of $3.6 million in compensatory damages. The jury found that Bard was negligent and that its negligence was a substantial factor in Christine Scott's harm (PR Newswire 2012).
https://www.prnewswire.com/news-releases/vaginal-mesh-lawsuits-pick-up-momentum-according-to-pulaski--middleman-llc-164552646.html

Knowing the Events and the Rules: How to Estimate

With the loss of the first lawsuit, requirement 450-20-25-2(a) was met, it was probable that a liability had been incurred. The next question was whether the loss could be reasonably estimated. Inputs into the estimate would include the number of lawsuits filed, the number of lawsuits expected to be filed, the percentage of lawsuits that would be lost, the damages to be awarded in those suits, the suits that could be settled, and the estimated dollar amount for the settlements. 450-20-25-5 required a firm to accrue a loss even when only a range of possible outcomes could be estimated.

Reporting over the Years

In 2012, Bard disclosed the nature and number of the lawsuits, but it did not report a contingent liability related to the lawsuits. In 2013, Bard lost a second case, its first in federal court (C.R. Bard, Inc. 2013). This judgment was for $2 million. The company also settled two cases, one in a state court and one federal multidistrict litigation suit (a suit with many plaintiffs). Bard disclosed that there were 10,395 plaintiffs with pending cases at year end. Bard disclosed the nature of the lawsuits and the number of plaintiffs in its 2014 10-K. https://www.sec.gov/Archives/edgar/data/9892/000119312515052531/d817237d10k.htm

Costs of the litigation and settlements were included in the *"Other Expenses"* category on the income statement, and a liability of $294 million was included in current liabilities as accrued expenses (C.R. Bard, Inc. 2014).

In 2014, the decision in the 2012 case was affirmed on appeal and the company reached an agreement with three plaintiffs' law firms to settle their cases representing more than 500 claims. The company also settled one federal multidistrict litigation case. Bard reported a $238 million charge to other expenses and a $288 million current liability of accrued expenses (C.R. Bard, Inc. 2014).

In 2015, the company reached agreements with various plaintiffs' law firms to settle their respective inventories of cases totaling approximately 6,285 claims. Bard reported expenses of $553 million and a current liability of $730 million (C.R. Bard, Inc. 2015).

In 2016, the company reached agreement with various plaintiffs' law firms to settle their respective inventories of cases totaling approximately 4,155 claims. It reported expenses of $139 million and a current liability of $810 (C.R. Bard, Inc. 2016). The liabilities sections of the 2016, 2015, 2014, and 2013 consolidated balance sheets on Bard's 10-K are presented in Exhibits 1 and 2 as follows:

Exhibit 1. Liabilities Section of Consolidated Balance Sheets for 2016 and 2015

Source: C.R. Bard, Inc. (2016). Form 10-K.

C. R. BARD, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(dollars in thousands except share and per share amounts)

	December 31, 2016	December 31, 2015
LIABILITIES AND SHAREHOLDERS' INVESTMENT		
Current liabilities		
Short-term borrowings and current maturities of long-term debt	$ —	$ 250,200
Accounts payable	96,000	70,700
Accrued expenses	809,500	728,900
Accrued compensation and benefits	186,100	187,900
Income taxes payable	17,300	23,000
Total current liabilities	1,108,900	1,260,700
Long-term debt	1,641,700	1,144,100
Other long-term liabilities	861,500	936,700
Deferred tax liabilities	18,900	47,200

Exhibit 2. Liabilities section of consolidated balance sheets for 2014 and 2013

Source: C.R. Bard, Inc. (2014). Form 10-K.

C. R. BARD, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(dollars in thousands except share and per share amounts)

	December 31, 2014	December 31, 2013
LIABILITIES AND SHAREHOLDERS' INVESTMENT		
Current liabilities		
Short-term borrowings	$ 78,000	$ —
Accounts payable	81,900	83,000
Accrued expenses	287,700	294,000
Accrued compensation and benefits	162,600	145,300
Income taxes payable	4,400	64,200
Total current liabilities	614,600	586,500
Long-term debt	1,401,900	1,405,700
Other long-term liabilities	1,125,300	798,800
Deferred income taxes	145,900	161,900

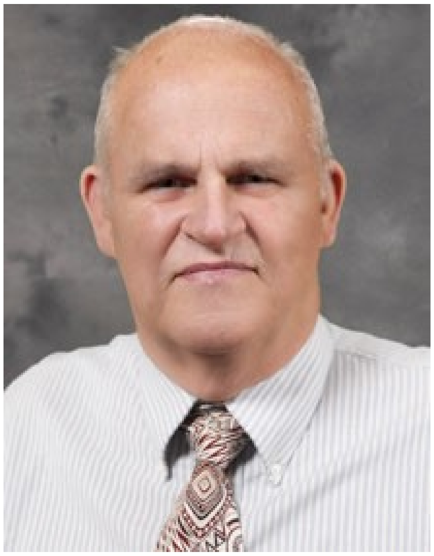
The Purchase

In December 2017, Bard was purchased by Becton, Dickinson and Company (BD). In the valuation of net assets acquired in the purchase, BD included the product liabilities acquired from Bard at a fair value of $2.029 billion (Becton, Dickinson and Company 2018). Not all of the $2 billion would be attributed to the pelvic mesh related product liability. Bard had two other products that were subject to significant product-liability lawsuits, *i.e.,* hernia surgery mesh and interior vena cava filters. However, the accrued expense of $810,000 on Bard's financial statements in 2016 included the liabilities for all of Bard's product liabilities – a significant difference from the amount BD recorded upon acquisition. Upon purchase, BD recorded an additional contingent liability of $1.2 billion.

Conclusion

Using accounting rules applicable to the situation, Bard was able to avoid reporting a contingent liability and loss for several years even when thousands of lawsuits had been filed and multiple lawsuits had been lost. In addition, when Bard did begin reporting the loss, the company spread the loss over four years and the total loss reported was only half of the total loss incurred. Why was Bard able to avoid reporting a contingent loss and liability?

Understanding that the purpose of financial accounting is to provide information that is useful to investors, and understanding that the liability was increased by $1.2 billion in consolidation, when should Bard have reported the $2.4 billion loss? Do the current accounting rules for contingent liabilities provide the most useful information to investors?



Steven C. Hall is a professor of Accounting at the University of Nebraska at Kearney. He got his bachelor degree in Accounting from Weber State College and his Ph.D. in Accounting from the University of Utah. He teaches primarily financial accounting topics, but over the decades has also taught auditing, accounting information systems, cost accounting, and finance. He served for several years as department chair. His primary research interest is in financial reporting quality. His research has appeared in a wide range of journals including *The Accounting Review, Journal of Business Finance and Accounting, Journal of Accounting Education, Journal of Accounting and Finance Research, Journal of Applied Business Research, Journal of Theoretical Accounting Research, Accounting Educators' Journal, Journal of Financial Education,* and the *Mountain Plains Journal of Business and Technology.*

Sarah Borchers is an assistant professor of Accounting at the University of Nebraska at Kearney (UNK). She holds a bachelor degree and MBA in Accounting from UNK, and a DBA in accounting from Creighton University. Before entering academia, Borchers worked for several years as an audit manager where she specialized in audits of governmental and non-profit entities. She teaches the principles of accounting courses, auditing, advanced auditing, and governmental and non-profit accounting. Her research interests include equity crowdfunding, auditing, and governmental accounting.

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