Background

In the fourth quarter of 2013, hackers broke into Target Corporation’s system and stole the names and credit card information for up to 70 million customers. This data breach is among the largest data breaches in U.S. history and lawsuits against Target Corporation are being filed by several parties including customers, credit card companies, State Attorneys General, and others. The financial effects of the data breach at Target is a good opportunity to see how contingent liabilities are accounted for under U.S. GAAP. Next are excerpts from Target Corporation’s 10-K for 2013 (Source: Target Corporation, SEC filings, 10-K filed 03/14/14, Notes to Financial Statements, pages 46 – 47).

Excerpts from 2013 Target Corporation 10-K Notes to Financial Statements

Note: Omitted words and phrases indicated by ...

“In the fourth quarter of 2013, we recorded $61 million of pretax Data Breach-related expenses, and expected insurance proceeds of $44 million, for net expenses of $17 million ($11 million after tax).... These expenses were included in our Consolidated Statements of Operations as Selling, General and Administrative Expenses (SG&A)... Expenses include costs to investigate ..., provide credit-monitoring services..., increase staffing in our call centers, and procure legal and other professional services.”

“The $61 million of fourth quarter expenses also include an accrual for the estimated probable loss related to the expected payment card networks’ claims by reason of the Data Breach. The ultimate amount of these claims will likely include amounts for incremental counterfeit fraud losses and non-ordinary course operating expenses (such as card reissuance costs) that the payment card networks believe they or their issuing banks have incurred... Currently, we can only reasonably estimate a loss associated with settlements of the networks' expected claims for non-ordinary course operating expenses. The year-end accrual does not include any amounts associated with the networks’ expected claims for alleged incremental counterfeit fraud losses because the loss..., while probable in our judgment, is not reasonably estimable... We believe that it is reasonably possible that the ultimate amount paid on payment card network claims could be material...”

“...State and federal agencies, including the State Attorneys General, the Federal Trade Commission and the SEC are investigating events related to the Data Breach, including how it occurred, its consequences and our responses. Although we are cooperating in these investigations, we may be subject to fines or other obligations. While a loss from these matters is reasonably possible, we cannot reasonably estimate a range of possible losses...we do not believe that a loss from these matters is probable; therefore, we have not recorded a loss contingency liability for litigation, claims and governmental investigations in 2013.”