



Board Meeting Handout

APPLICABILITY OF FASB INTERPRETATION NO. 48, *ACCOUNTING FOR UNCERTAINTY IN INCOME TAXES*, TO PRIVATE COMPANIES

October 1, 2008

PURPOSE

The purpose of this meeting is to ask the Board to decide whether a deferral or any other modifications should be provided for private companies in Interpretation 48.

ISSUE 1: SCOPE OF INTERPRETATION 48

The staff believes that there are three alternatives relating to the scope of Interpretation 48 for the Board to consider: (1) exempt all private companies from Interpretation 48 in its entirety, (2) exempt pass-through entities from Interpretation 48 in its entirety, or (3) do not change the scope of Interpretation 48.

Alternative 1: Exempt all Private Entities

Proponents of this alternative cite cost benefit considerations. They also claim that the users of private company financial statements do not use the information required by the Interpretation. Supporters also argue that for many private companies the uncertain tax positions may be immaterial, but preparers and their outside CPAs still have to analyze those positions to make that determination, incurring cost without providing benefits to the users.

Opponents of this alternative believe the incremental cost of compliance is not significant since the CPA practitioner is generally involved in the entity's accounting through all phases of the process to generate the tax returns and financial statements, and, therefore, the CPA practitioner is already aware of possible uncertain tax positions. In circumstances where the CPA practitioner is not involved in the company's tax return process, such as private companies with inhouse tax departments, opponents of a complete exemption believe that the cost of compliance is not more burdensome than it would be for a public company.

Alternative 2: Exempt Pass-through Entities

Supporters of this alternative believe that the cost of implementation is burdensome for many private entities and the result is likely immaterial, but they believe that C Corporations should not be exempt because C Corporations are tax paying entities and may have material uncertain tax positions. Some supporters believe that the only issue for pass-through entities is whether the pass-through status is permitted, and since the pass-through status is rarely, if ever, challenged, these entities should not be subject to the Interpretation. Other supporters note additional difficulties associated with applying the interpretation to pass-through entities.

Opponents of this alternative believe that the incremental cost of compliance for pass-through entities is not significant. They also question which pass-through status would qualify the entity

for the exemption--the federal status, the state status, a foreign status if applicable, or all of the above.

Alternative 3: Do Not Change the Scope of Interpretation 48

Proponents of Alternative 3 believe that the deferral granted to private companies has given them sufficient time to learn about the provisions of Interpretation 48 and to apply them. They believe that all entities, public or private, can have uncertain tax positions, and those uncertain tax positions should be appropriately accounted for. Proponents also believe that because of the nature of the relationship between the entity and its outside accountant, the incremental costs to comply with the interpretation are not significant. They believe that for larger private companies that prepare their own tax returns and financial statements, the incremental costs would not be disproportionately larger for private companies than for public companies.

Staff Recommendation

The staff recommends not changing the scope of Interpretation 48.

Q1: Does the Board agree with the staff's recommendation to not modify the scope of Interpretation 48? If not, which alternative do you prefer?

ISSUE 2: GUIDANCE FOR PASS-THROUGH ENTITIES

Private company constituents have stated that they are looking for guidance to address basic issues such as when and how the Interpretation applies to pass-through entities if the Board does not entirely exempt these entities from the scope. For example, they questioned whether a pass-through entity should record a liability for an uncertain tax position in a state in which the entity has nexus because any assessment of taxes would be against the owners, not the entity. If a liability was recorded, they asked whether the offsetting debit would be a charge directly to equity or an income tax that would appear on the income statement. The staff has also received other questions such as how a pass-through entity should apply the Interpretation if the parent entity is a pass-through entity domestically but has a foreign subsidiary that is not a pass-through.

At the November 7, 2007 meeting, the Board decided not to issue such guidance because they believed the deferral would provide the AICPA or other CPE providers time to issue the guidance in their materials. The staff is not aware of detailed guidance for pass-through entities and has been informed that such guidance would generally have to come from the FASB before third parties would include it in their guidance.

Staff Recommendation

The staff recommends that the Board develop guidance for pass-through entities because there is confusion about how to apply the Interpretation. The staff believes confusion will result in diversity in practice.

Q2: Does the Board agree with the staff's recommendation to provide guidance for Interpretation 48's applicability to pass-through entities?

ISSUE 2A: DEFERRAL FOR PASS-THROUGH ENTITIES UNTIL THE GUIDANCE IS ISSUED

If the Board agrees to issue guidance for pass-through entities, a related issue is whether the Board should defer the effective date of the Interpretation for pass-through entities.

Staff Recommendation

The staff recommends the deferral because the staff is concerned that pass-through entities may misapply the Interpretation without the related guidance, only to discover that their understanding was incorrect when the guidance is issued at a later date. With a deferral, the guidance would be in place and could be communicated before pass-through entities would be required to apply the Interpretation. Without a deferral, the staff is concerned that the guidance would not be in place in time to be communicated to pass-through entities before they are required to apply the Interpretation.

Q3: Does the Board agree with the staff's recommendation to defer Interpretation 48 for pass-through entities? A question on the deferral for all private companies will be included in Issue 3.

ISSUE 3: AMENDMENTS TO DISCLOSURE REQUIREMENTS FOR ALL PRIVATE ENTITIES

Based on discussions with private company financial statement users, all users agreed that disclosure relief was necessary for private companies. Members of a user panel unanimously agreed that the roll-forward disclosure in paragraph 21(a) was burdensome and did not provide meaningful information. They also recognized that the disclosures could provide a roadmap for taxing authorities even though the uncertain tax positions would be aggregated. Many private companies have only one or two uncertain tax positions.

The users did not believe the disclosure in paragraph 21(b) was useful since many of the unrecognized tax benefits may not be recognized within the next fiscal year, if ever, and as such, were not relevant for their cash flow analyses. They indicated that the actual liability to be paid during the next year was important, not a possible liability in the future.

The users generally did not believe the disclosure in paragraph 21(d) was necessary because of the disclosure requirements of AICPA Statement of Position (SOP) 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, and FASB Statement No. 5, *Accounting for Contingencies*, were sufficient. The users did not think the disclosure in paragraph 21(e) was necessary, but they believed that it could be helpful. One user noted that the disclosures in paragraph 20 and 21(c), regarding the treatment and classification of interest and penalties, should be retained because it could indicate the company had made delinquent tax payments or miscalculated them.

Appendix 1 of this handout shows the existing disclosure requirements in Interpretation 48 marked to show the staff's recommended exemptions for private companies.

Staff Recommendation

Based on conversations with private company users, the staff does not believe that the information about unrecognized tax benefits in paragraphs 21(a) and 21(b) are cost effective. Accordingly, the staff recommends that these disclosures be deleted for private companies. However, the staff recommends that the remainder of the disclosures be retained.

The staff believes such information in paragraphs 21(c) and 21(e) should not be difficult or costly for private company preparers to provide. The staff believes that the disclosure in paragraph 21(d) is necessary because Interpretation 48 amends Statement 5 to explicitly exclude income taxes from its scope. Without that disclosure private company users would no longer have an estimate of the possible loss or range of possible loss, or the statement that such an estimate cannot be made, for uncertainties in income taxes.

Q4: Does the Board agree with the staff's recommendation to delete the disclosure in paragraph 21(a) for private entities?

Q5: Does the Board agree with the staff's recommendation to delete the disclosure in paragraph 21(b) for private entities?

Q6: Does the Board agree with the staff's recommendation to keep the disclosures in paragraphs 20 and 21(c)–(e) for private entities?

ISSUE 3A: DEFERRAL FOR ALL PRIVATE ENTITIES IF DISCLOSURE REQUIREMENTS ARE MODIFIED

Many private company constituents request an additional deferral for all private companies until the completion of the joint income tax project. Some constituents have also requested the deferral to provide the Board with adequate time to amend the disclosure requirements for all private companies.

Staff Recommendation

The staff does not recommend the deferral for all private companies since the staff believes that amendments to the disclosures can be provided in a timely fashion. While the staff believes that pass-through entities should have a deferral for the reasons mentioned above, the staff believes that C corporations have had adequate time to learn about and apply the provisions of the Interpretation and therefore do not need an additional deferral if only the disclosure requirements are modified. Reducing the disclosure requirements should reduce complexity and therefore not necessitate an additional deferral.

ISSUE 4: COMMENT PERIOD AND PROJECT PLAN

Based on discussions with private companies and private company CPA practitioners, the staff recommends an FASB Staff Position (FSP) be issued before year-end, if possible, that amends or provides guidance on the recognition, measurement, or disclosures currently in Interpretation 48 in order to communicate any amendments to the existing requirements before private companies with calendar-year ends begin to prepare their annual financial statements.

Staff Recommendation

If the Board decides to issue a deferral for all private companies, the staff recommends that the Board should first issue a proposed FSP with a 15-day comment period that defers the Interpretation. The staff believes that a shorter comment period is permissible because the staff does not expect many, if any, constituents to be against the proposal. The Board can then subsequently issue an additional proposed FSP with a longer comment period to address the disclosures, guidance for pass-through entities, and any other private company issues for Interpretation 48.

If the Board decides to issue a deferral for only pass-through entities, the staff recommends that a single proposed FSP be issued with a 30-day comment period that also contains the amendments to the disclosures. The guidance for pass-through entities would then be developed subsequent to the issuance of the first FSP.

If the Board does not support any deferral, the staff recommends a 30-day comment period and believes that both the guidance for pass-through entities and the amendments to the disclosures should be included. However, the staff is concerned that such a project may not be completed by the end of the year and the staff believes that the comment period relating to the guidance for pass-through entities should be longer to solicit feedback of any unintended consequences and any additional problems related to the application of the Interpretation by pass-through entities.

Q7: Does the Board agree with the staff recommendation?

Appendix 1

Disclosures

20. An enterprise shall disclose its policy on classification of interest and penalties in accordance with paragraph 19 of this Interpretation in the footnotes to the financial statements.

21. An enterprise shall disclose the following at the end of each annual reporting period presented:

- a. ~~A tabular reconciliation of the total amounts of unrecognized tax benefits at the beginning and end of the period, which shall include at a minimum:~~
 - ~~(1) The gross amounts of the increases and decreases in unrecognized tax benefits as a result of tax positions taken during a prior period~~
 - ~~(2) The gross amounts of increases and decreases in unrecognized tax benefits as a result of tax positions taken during the current period~~
 - ~~(3) The amounts of decreases in the unrecognized tax benefits relating to settlements with taxing authorities~~
 - ~~(4) Reductions to unrecognized tax benefits as a result of a lapse of the applicable statute of limitations~~
- b. ~~The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate~~
- ea. The total amounts of interest and penalties recognized in the statement of operations and the total amounts of interest and penalties recognized in the statement of financial position
- b. For positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date:
 - (1) The nature of the uncertainty
 - (2) The nature of the event that could occur in the next 12 months that would cause the change
 - (3) An estimate of the range of the reasonably possible change or a statement that an estimate of the range cannot be made
- ec. A description of tax years that remain subject to examination by major tax jurisdictions.



Board Meeting Handout

October 1, 2008

Proposed FASB Staff Position No. FAS 157-d: *Determining Fair Value in a Market That Is Not Active*

PURPOSE OF MEETING

1. The staff seeks a decision from the Board regarding whether to issue an FSP for comment containing an example that illustrates key principles for determining fair value in a market that is not active.

BACKGROUND

2. FASB Statement No. 157, *Fair Value Measurements*, establishes a single definition of fair value and a framework for measuring fair value in generally accepted accounting principles (GAAP) that should result in increased consistency and comparability in fair value measurements. The Statement also expands disclosures about fair value measurements, improving the quality of information provided to users of financial statements.
3. Statement 157 was issued on September 15, 2006, and made effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. However, FSP FAS 157-2, *Effective Date of FASB Statement No. 157*, amended Statement 157 to delay application of the guidance for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until fiscal years beginning after November 15, 2008, and interim periods within those fiscal years.
4. The staff has obtained input from various constituents on the application of fair value measurements. Many have indicated that the fair value measurement framework in Statement 157 and related disclosures have improved the quality and transparency of financial information. Certain constituents, however, have expressed concerns that Statement 157 does not provide sufficient guidance on how to determine fair value in markets that are not active. These concerns include:

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- a. How management's internal assumptions (that is, expected cash flows) should be considered when measuring fair value when relevant market data does not exist
 - b. How observable market information in a market that is not active affect fair value measurements
 - c. How the use of market quotes (for example, broker quotes or pricing services for the same or similar securities) should be considered when assessing the relevance of observable and unobservable inputs available to measure fair value.
5. The Office of the Chief Accountant of the SEC and the FASB staff jointly issued a press release on September 30, 2008, that addresses similar Statement 157 implementation issues. That press release provides financial statement users, investors, preparers, and auditors with additional guidance on these matters and is consistent with this proposed FSP.

OBJECTIVES OF THE PROPOSED GUIDANCE

6. The FASB staff has developed proposed FSP FAS 157-d to clarify Statement 157 in an inactive market and provides an illustrative example of how to determine the fair value of a financial asset when the market for that financial asset is not active. The objective of the guidance is to clarify the framework within which financial statement users, preparers, auditors, and others are to determine the fair value of assets and liabilities when markets are not active. For purposes of meeting that objective, the example will illustrate several key principles of Statement 157 including the following:
- a. In some cases an entity might determine that observable inputs to a market approach valuation technique require significant adjustment and thus are ultimately considered unobservable or Level 3 inputs. The entity might then conclude that an income approach valuation technique that uses management's internal assumptions about market participants' expectations of cash flows is equally or more representative of fair value. However, regardless of the valuation technique used, entities must include appropriate adjustments that market participants would make for risks, such as nonperformance and liquidity.
 - b. A fair value measurement represents the price at which a transaction would occur between market participants at the measurement date. As discussed in paragraph 30 of Statement 157, in situations in which there is little, if any, market activity for an asset or liability at

the measurement date, the fair value measurement objective remains the same, that is, an exit price from the perspective of a market participant.

- c. Broker quotes or pricing services may be a relevant input when measuring fair value, but not necessarily determinative if an active market does not exist for the security. In weighing a broker quote as an input to fair value, an entity should place less reliance on quotes that do not reflect the result of market transactions.

QUESTIONS FOR THE BOARD

The staff has three questions for the Board to be addressed at this meeting:

1. Does the Board have any comments or questions regarding the draft, proposed FSP?
2. The staff recommends that a final FSP be effective upon issuance. Does the Board agree with the staff's recommendation?
3. The staff recommends an accelerated comment period ending October 9, 2008, (approximately 7 days) such that the Board can finalize the proposed FSP at its Board meeting on October 10, 2008. Does the Board agree with the staff's recommendation?