

FIN 48 and FAS 109: Bringing Disclosure and Transparency into Focus.



FIN 48 and FAS 109: Bringing disclosure and transparency into focus

Most public companies have adopted FIN 48 and disclosed the impact of that adoption in their first-quarter reports. Now, those companies are turning their attention to annual disclosure requirements and understanding expectations surrounding transparency of information.

Deloitte hosted a Dbriefs webcast on December 10, 2007, to discuss FASB and SEC rules of disclosure and considerations for the months ahead. More than 3,500 participants tuned in to learn more about leading practices and expectations for transparency and to share their views through a series of polling questions. Please see “Tax executives’ views” on pages 3 and 4 of this report for more information.

The regulatory environment and expectations for transparency

Today’s regulatory environment has created unprecedented scrutiny—from all directions—on corporate taxes. The Securities and Exchange Commission (SEC) is commenting on the adequacy of income tax disclosures. The Public Company Accounting Oversight Board inspections have focused on income taxes as a high-risk area and have noted various deficiencies. The Internal Revenue Service policy of restraint regarding access to workpapers is under pressure. The Senate Permanent Subcommittee on Investigations is asking companies about income tax items related to foreign planning. The Financial Accounting Standards Board (FASB) has spent a significant amount of time revamping accounting for uncertainties in income taxes. And, the FASB and International Accounting Standards Board continue their efforts toward convergence, requiring companies to evaluate International Financial Reporting Standards versus US GAAP.

Understanding the SEC’s expectations on income tax disclosures will come about largely through the SEC comment letter process. We are now just beginning to see the first comments relating to FIN 48. While these early comments tend to be more “educational” in nature—reflecting the first reviews of this area—we can expect the comments to become more detailed and frequent during the next review process.

Exhibit A shares excerpts from three recent comments. Even without knowing the details of these situations, it is possible to identify evolving areas of concern. For example, Comment A-1 references disclosure requirements of paragraph 21(d) and indicates that the enterprise’s disclosure may have lacked the detail sought under the new requirements. Similarly, Comment A-2 demonstrates the increased level of specificity required under paragraph 21(d), but it also indicates a potential need to disclose certain items, even when they are immaterial. Comment A-3 illustrates the requirement to include unrecognized tax benefits in the contractual obligations table.

Exhibit A: Sample SEC comments on disclosure

Editor’s Note: Underlining has been added for emphasis. They did not appear in the original SEC comments.

A-1: Paragraph 21(d)

We note your disclosures regarding the transfer pricing uncertainty and the various other uncertain tax positions related to federal taxes which are being discussed at the IRS Appeals level in the U.S. Tell us how you have met each of the disclosure requirements of paragraph 21(d) of FIN 48 for each significant uncertain tax position.

A-2: Paragraph 21(d)

We note your disclosures regarding the adoption of FIN 48 as of January 1, 2007. Please revise your disclosure to address whether it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date. Identify the nature of any uncertainties, the nature of the events that could occur within the next 12 months that could cause the amounts to change, and provide an estimate of the range of the reasonable possible change or state that an estimate of the range cannot be made. Refer to paragraph 21(d) of FIN 48 and the AICPA’s February 2007 FIN 48 disclosure summary, which sets forth Staff views with respect to these disclosures in the initial period of adoption.

A-3: Contractual obligations table

We note that no disclosure was made regarding material changes in contractual obligations from the amounts that were previously reported in your Form 10-K for the year ended December 31, 2006. Please tell us how you evaluated Instruction 7 to Item 303(b) of Regulation S-K with respect to contractual obligations relating to FIN 48. We note that it does not appear that your prior disclosure of contractual obligations included amounts relating to uncertain tax positions, and we believe that such amounts represent contractual obligations that should be included in the disclosures made under Item 303(a)(5) of Regulation S-K.

Disclosure requirements and trends

Under the FIN 48 disclosure requirements, an enterprise must include a tabular reconciliation of the total amounts of unrecognized tax benefits (not including interest and penalties) from the beginning to the end of the period (¶ 21a). Exhibit B provides an example of a tabular reconciliation. While the particular line items will depend on a company and its circumstances, the tabular reconciliation should include:

- The gross amounts of the increases and decreases in unrecognized tax benefits resulting from tax positions taken during the prior period.
- Increases in unrecognized tax benefits resulting from tax positions taken during the current period.
- Decreases in unrecognized tax benefits relating to settlements with taxing authorities; however, the difference between the FIN 48 liability and the cash settlement should be included in the gross amounts of increases and decreases in unrecognized tax benefits resulting from tax positions taken during the prior period.
- Reductions in unrecognized tax benefits resulting from a lapse of the applicable statute of limitations.



Exhibit B: Sample tabular reconciliation

Unrecognized tax benefits, opening balance	\$XX
Gross increases – tax positions in prior period	XX
Gross decreases – tax positions in prior period	(XX)
Gross increases – current-period tax positions	XX
Settlements	(XX)
Lapse of statute of limitations	(XX)
Unrecognized tax benefits, ending balance	\$XX

FIN 48 disclosure requirements also mandate disclosure of certain items, including:

- The amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate (§ 21b).
- The amount of interest and penalties—disclosed separately, not aggregated—recognized in the income statement and balance sheet (§ 21c).
- Information for tax 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 (§ 21d). Often referred to as the “early warning disclosure,” this rule requires companies to disclose the nature of the uncertainty, the nature of the event that could occur in the next 12 months that would cause the change, and an estimate of the range of reasonably possible change or a statement that an estimate of range cannot be made.
- A description of the tax years that remain subject to examination by a major tax jurisdiction (§ 21e).

While some disclosure requirements are clear, others may not be as clear. For example, a disclosure requirement that lacks clarity is the amount of detail required under paragraph 21(d)—the controversial early warning disclosure requirement that some fear could provide a roadmap for taxing authorities. There is no guidance on the appropriate level of aggregation of information, so enterprises must use judgment. Many of the initial disclosures have aggregated the required information and provided little detail; however, a disclosure with little detail may be more likely in the future to elicit comments from the SEC staff.

Implications for management discussion and analysis

With the recent issuance of FIN 48 and the increased scrutiny on accounting for income taxes, companies now may want to take a fresh look at their Management Discussion and Analysis (MD&A) disclosures to ensure that they clearly portray the significance of management’s assumptions about future events and current accounting results. Companies should explain reasons for significant changes in the effective tax rate from year to year and the effects that income tax payments may have on liquidity and capital resources.

In addition, companies should include FIN 48 liabilities in the contractual obligations table in the MD&A section when they can establish a reasonably reliable estimate about the period of cash settlement for those liabilities. For example, if a FIN 48 liability is classified as a current liability in the balance sheet, that amount should appear in the less-than-one-year column of the contractual

obligations table. On the other hand, if the enterprise cannot estimate the period of a future cash payment for a FIN 48 liability, it may choose to exclude that amount from the contractual obligations table or disclose the amount within an “other” column. In this case, it should use a footnote to disclose the amount excluded and the basis for the exclusion.

Actions to take in the near term

Whether your organization is addressing quarterly reporting requirements for the first time or you are preparing your first annual financial statements under FIN 48, there are many things to think about over the next few months.

One area of continuing focus should be documentation—ensuring that it is robust and that sound processes are in place for identifying and documenting new uncertain tax positions arising during the past year. In addition, you will want to make sure you have clear documentation about any new information for both recognition and measurement of tax positions. Even if your tax positions meet the more-likely-than-not recognition threshold, you will want to document your process for ensuring that there is no need to reassess recognition.

You should make sure that any uncertainties about financial statement presentations or ongoing discussions with external auditors are satisfied and clear. Don’t forget to update your assessment of current versus non-current FIN 48 liabilities and to provide the required year-end disclosures, including the tabular reconciliation, the paragraph 21(d) disclosure, and the contractual obligations table.

If you have not begun to do so, this is a good time to work with your enterprise’s SEC counsel to plan for next summer’s SEC comment period.

Finally, if your enterprise is nonpublic and subject to the one-year deferral—i.e., because your enterprise has not issued a full set of U.S. GAAP annual financial statements using the requirements of FIN 48 or is not a consolidated subsidiary of a public enterprise—it is not too early to begin preparing for adoption. In a previous Dbriefs webcast on FIN 48, participants shared their best advice for those who had not yet adopted the Interpretation: bring more resources to the table and plan to spend more time than you anticipated documenting your recognition step.

Other reporting requirements

While FIN 48 is changing the complexion of disclosure significantly, companies should not forget about other important disclosure requirements:

- FAS 109 — paragraphs 43-49
- FAS 5 — disclose loss contingencies for non-income tax related items
- FIN 45 — disclose indemnifications provided
- SOP 94-6 — disclose when it is reasonably possible that an accounting estimate will change in the near-term
- Schedule II — rollforward valuation and qualifying accounts

Tax executives' views

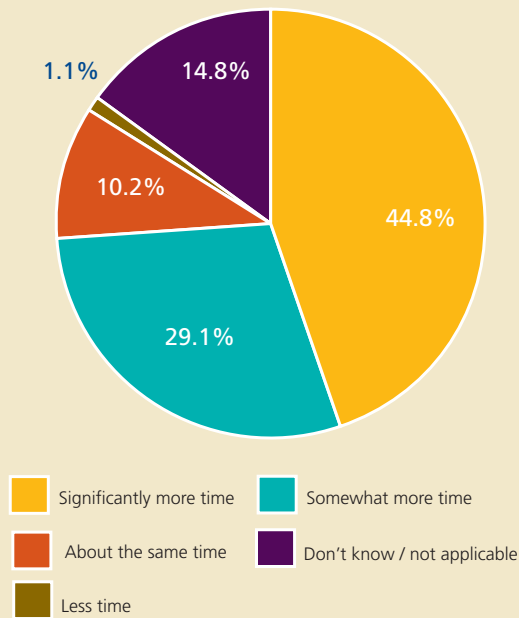
Deloitte hosted a “Dbriefs” webcast entitled “*FIN 48 and FAS 109: Bringing Disclosure and Transparency into Focus*” on December 10, 2007. During the webcast, FAS 109 specialists discussed FASB and SEC rules of disclosure and considerations for the months ahead. More than 3,500 participants tuned in to learn more about leading practices and expectations for transparency and to share their views through a series of polling questions.

Not surprisingly, webcast participants reported that their companies are spending significantly more time this year on income tax accounting and reporting than they have in the past. Nearly three-

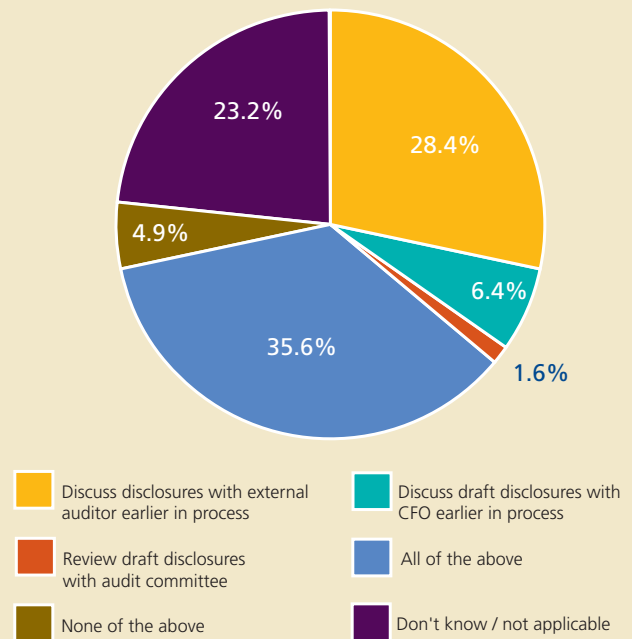
quarters of the respondents reported spending more time on income tax accounting and reporting, and more than half of those reported spending significantly more time on the issue.

In addition to adapting to new rules, these companies also are responding to changing expectations around transparency of information. The focus on increased transparency has led some enterprises to discuss draft disclosures with their external auditors earlier in the year-end reporting process. Discussions with CFOs on disclosure drafts also are happening sooner in some cases.

How much time has your organization spent on its income tax accounting and reporting this year as compared to the prior year?



What has your organization done to cope with the increased expectations regarding transparency?



Tax executives' views (continued)

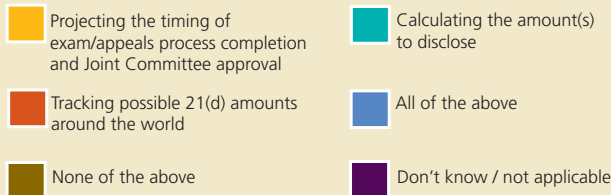
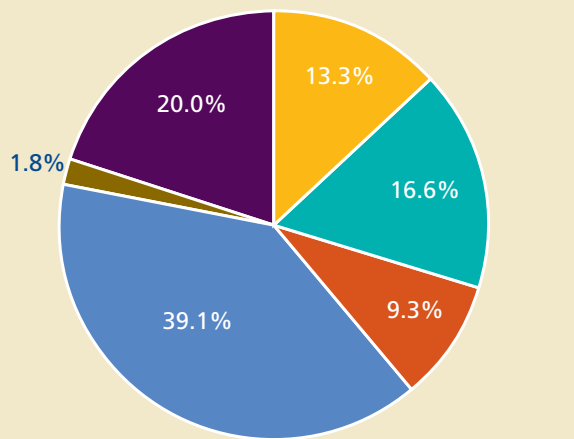
Developing a paragraph 21(d) disclosure has many enterprises in a quandary. The greatest difficulties appear to be calculating the amount(s) to disclose and projecting the timing of exam and/or appeals process completion and Joint Committee approval. For enterprises with global operations, tracking possible 21(d) amounts from around the world is another major challenge.

More than half of the respondents, 58.4 percent, reported that adopting FIN 48 has helped to improve their organizations' understanding of their

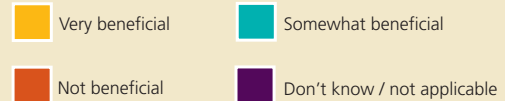
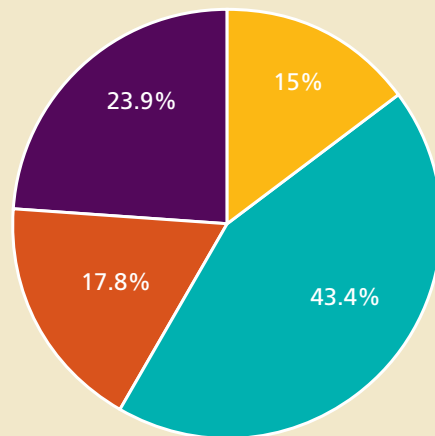
income tax uncertainties. Nearly 18 percent, on the other hand, indicate that adoption of FIN 48 has not helped to clarify their organizations' understanding of their income tax uncertainties.

Of course, the final outlook may not be clear until those enterprises that have fully implemented FIN 48 get through their first year of disclosing uncertain tax positions in their financial statements.

What do you believe will be the most difficult part of developing a paragraph 21(d) disclosure for your organization?



How beneficial has the adoption of FIN 48 been to improving your organization's understanding of its income tax uncertainties?



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