

Disclosures under FASB Interpretation No. 48 in Form 10-Q in the Period of Adoption

Historically, the SEC staff has required that interim period financial statements filed on Form 10-Q that include the adoption of a new accounting standards in that interim period present all the disclosures required by the new standard. In addition, the SEC Staff has previously required that those disclosures continue to be provided in interim period financial statements filed on Form 10-Q subsequent to the quarter of adoption until the first annual financial statements are filed on Form 10-K after adoption that contain the required disclosures. (See, for example, Discussion Document E from the June 20, 2006 meeting.) FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, is effective in the first interim period for fiscal years beginning after December 15, 2006. Paragraphs 20 and 21 of FIN 48 establish a number of disclosures that are required on an annual basis. However, FIN 48 does not require (or permit) retrospective application. Accordingly, when a company first adopts FIN 48 in a quarter, it is unclear how to approach the initial disclosure of information that relates to annual periods.

Issue/Question:

What disclosures should be made by a public company in its Form 10-Q in the period of adoption?

The following is a list of the disclosure requirements under FIN 48. For each disclosure requirement please indicate if the disclosure is required (1) as of the date of adoption (i.e., those which must be included in all interim financial statements in the year of adoption), and (2) in interim periods post adoption, which would address interim balances or activity during the current and year-to-date interim periods. The Committee's recommendations are provided in the table below.

Appendix A
Revised as of February 6, 2007

FIN 48 Disclosures	Disclosure as of date of adoption¹	Disclosure as to interim periods post adoption²
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.	Yes⁴	Disclose any change in classification
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:	Total amount of unrecognized tax benefits as of date of adoption	Tabular reconciliation not required for interim periods
(1) The gross amounts of the increases and decreases in unrecognized tax benefits as a result of tax positions taken during a prior period	N/A	Disclose any material changes
(2) The gross amounts of increases and decreases in unrecognized tax benefits as a result of tax positions taken during the current period	N/A	Disclose any material changes³
(3) The amounts of decreases in the unrecognized tax benefits relating to settlements with taxing authorities	N/A	Disclose any material changes³
(4) Reductions to unrecognized tax benefits as a result of a lapse of the applicable statute of limitations	N/A	Disclose any material changes³
b. The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate	Yes, amount of as of date of adoption	Disclose any material changes
c. 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 ⁴	Total amount of accrued interest and penalties as of date of adoption	Disclose any material changes⁴
d. 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:	Yes, amount of as of date of adoption	Disclose any material changes⁵
(1) The nature of the uncertainty	Yes, as of date of adoption	Disclose any material changes
(2) The nature of the event that could occur in the next 12 months that would cause the change	Yes, as of date of adoption	Disclose any material changes
(3) An estimate of the range of the reasonably possible change or a statement that an estimate of the range cannot be made	Yes, estimate of as of date of adoption	Disclose any material changes
e. A description of tax years that remain subject to examination by major tax jurisdictions.	Yes, as of date of adoption	Disclose any material changes

¹ Disclose in all interim financial statements in the year of adoption

² Regarding interim balances or activity during the current and year-to-date interim periods

³ If material amounts are recognized during the quarter, disclosure in management's discussion and analysis may be required.

⁴ See SEC Staff Position below regarding supplemental disclosures for interest and penalties in pre-adoption periods.

⁵ If material amounts are updated during the quarter disclosure in management's discussion and analysis may be required and critical accounting policies may need to be updated.

SEC Staff Position: The SEC staff agrees that this approach to disclosures is reasonable. In addition, registrants should consider the following disclosures regarding the classification of interest and penalties under paragraphs 20 and 21(c) of FIN 48.

Change in classification upon adoption:

If upon adoption of FIN 48, a registrant adopts a new financial statement classification of interest and penalties, it should disclose that it has adopted a new accounting principle and disclose its new policy for classification of interest and penalties. Because FIN 48 transition does not allow any form of retroactive application, financial statements for periods presented prior to adoption of FIN 48 should not be retroactively restated or reclassified to conform to the newly adopted accounting principle. However, a registrant should disclose its policy for the classification of interest and penalties for prior periods. Also, see “Other Implementation Questions” below regarding preferability.

Change in classification subsequent to adoption:

If subsequent to the first quarter of the year of adoption of FIN 48, a registrant changes its financial statement classification of interest and penalties, it should provide the disclosures specified by paragraphs 17 and 18 of FASB Statement No. 154, *Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3* (FAS 154) and file a preferability letter (post adoption). This change in accounting principle would be retrospectively applied beginning with the first interim period in which FIN 48 was applied. Periods prior to the adoption of FIN 48 should not be retroactively restated or reclassified, because FIN 48 transition does not allow retroactive application.

Additional disclosures for such changes in classification:

If a registrant has changed its classification policy, the SEC staff believes the registrant should disclose, in annual financial statements that include any period prior to the adoption of FIN 48, both the classification and amount of interest and penalties on uncertain income tax positions reflected in each income statement. In those circumstances, if the registrant cannot determine the amount of interest and penalties for periods prior to the adoption of FIN 48 due to its inability to disaggregate the interest or penalties portion of the accrual from the underlying tax exposure, it should disclose that fact.

Other Implementation Questions

Income statement classification of interest and penalties for income tax deficiencies under FASB Interpretation No. 48

Item 601(b)(18) of Regulation S-K requires a preferability letter for changes in accounting principles, except when the change is the result of the application of a new standard. Neither FASB Statement No. 109, *Accounting for Income Taxes*, nor FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, specifies how interest and penalties on income tax deficiencies should be classified. However, FIN 48 states that classification of these items is an accounting policy that requires disclosure.

Issues/Questions:

1. If a registrant changes its income statement classification of interest and/or penalties in connection with the adoption of FIN 48, is a preferability letter required?

Committee Recommendation: No. While technically such a change might represent an accounting change for which FAS 154 would require a registrant to establish preferability, the recognition and measurement attributes of tax positions (and possibly the related interest and penalties) may significantly differ under FIN 48 (resulting in potentially larger amounts of interest and penalties). Accordingly, the Committee believes it appropriate for a registrant to have a one-time “safe harbor” upon the adoption of FIN 48 to change its classification policy without establishing preferability.

SEC Staff Position: The SEC staff noted that acceptable alternatives to the income statement classification of interest and/or penalties on income tax contingencies existed prior to FIN 48 and continue to exist after FIN 48. However, after further consideration, because the accounting model for tax contingencies and interest has fundamentally changed, the SEC staff would not require justification of the change pursuant to paragraph 13 of Statement 154 or a preferability letter upon adoption of FIN 48.

2. If a registrant changes its income statement classification of interest and/or penalties after the adoption of FIN 48, is a preferability letter required?

Committee Recommendation: Yes

SEC Staff Position: After the adoption of FIN 48, the SEC staff agreed that a preferability letter is required for a material change in a registrant's accounting policy regarding the classification of interest and/or penalties on income tax contingencies.