

SEC Regulations Committee
April 17, 2007 - Joint Meeting with SEC Staff
SEC Offices – Washington DC

Discussion Document E

Topic: Disclosure of FIN 48 Liabilities in the Contractual Obligations Table

Issue:

Are FIN 48 liabilities required to be included in the MD&A tabular disclosure of contractual obligations?

Background:

Regulation S-K Item 303(a)(5) requires MD&A for annual periods to include a tabular disclosure of "known contractual obligations," including those related to long-term debt obligations, capital lease obligations, operating lease obligations, and purchase obligations. The prescribed table also includes the caption "other long-term liabilities reflected on the registrant's balance sheet under GAAP."

Instruction 7 to Regulation S-K Item 303(b) states, "The registrant is not required to include the table required by paragraph (a)(5) of this Item for interim periods. Instead, the registrant should disclose material changes outside the ordinary course of the registrant's business in the specified contractual obligations during the interim period."

FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, FIN 48, is effective for fiscal years beginning after December 15, 2006. FIN 48 removes income taxes from the scope of FASB Statement No. 5, *Accounting for Contingencies*, and creates a single model to address uncertainty in income tax positions. FIN 48 utilizes a two-step approach for the recognition and measurement of tax positions. Recognition requires the enterprise to conclude that a tax position, based solely on its technical merits, is more likely than not to be sustained upon examination. Measurement is based on the largest amount of benefit, determined on a cumulative probability basis, that is more likely than not to be realized upon ultimate settlement. Those tax positions failing to qualify for initial recognition are recognized in the first subsequent interim period that they meet the more-likely-than-not standard, are resolved through negotiation or litigation with the taxing authority, or on expiration of the statute of limitations.

Paragraph 17 of FIN 48 states,

As a result of applying this Interpretation, the amount of benefit recognized in the statement of financial position may differ from the amount taken or expected to be taken in a tax return for the current year. These differences represent unrecognized tax benefits, which are the differences between a tax position taken or expected to be taken in a tax return and the benefit recognized and measured pursuant to this Interpretation. A liability is created (or the amount of a net operating loss carryforward or amount refundable is reduced) for an unrecognized tax benefit because it represents an enterprise's potential future obligation to the taxing authority for a tax position that was not recognized pursuant to this Interpretation. An enterprise that presents a classified statement of financial position shall classify a liability associated with an unrecognized tax benefit as a current liability (or the amount of a net operating loss carryforward or amount refundable is reduced) to the extent the enterprise anticipates payment (or receipt) of cash within one year or the operating cycle, if longer. The liability for unrecognized tax benefits (or reduction in

amounts refundable) shall not be combined with deferred tax liabilities or assets.
(Emphasis added)

At the 2006 AICPA National Conference on Current SEC and PCAOB Developments, a member of the SEC staff stated that, given the objectives of the table and its usefulness to investors, it made sense to include FIN 48 liabilities in the contractual obligations table, with disclosure in the footnotes to the table of any assumptions underlying the estimates of the periods in which such liabilities will be settled in cash.

Question 1:

Must a registrant's tabular disclosure of contractual obligations include liabilities for unrecognized tax benefits recorded under FIN 48?

View A: Yes. FIN 48 liabilities are reflected on the registrant's balance sheet under GAAP as current liabilities and/or other long-term liabilities. Accordingly, the registrant should include all FIN 48 liabilities in its contractual obligations table based on its best estimate of the period of settlement. In addition, any significant judgments made by management when disclosing such liabilities in the contractual obligations table should be discussed in the footnotes accompanying the table.

View B: No. While FIN 48 liabilities are legally enforceable obligations, they are not contractual obligations. Because the scope of MD&A table is limited to contractual obligations, a registrant should not include any FIN 48 liabilities in its contractual obligations table.

View C: Yes, a registrant should consider FIN 48 liabilities for inclusion in the contractual obligations table in MD&A. A registrant should include FIN 48 liabilities in the contractual obligations table if it can make reasonable estimates about the related demands on its liquidity. For example, if any FIN 48 liabilities are classified as a current liability in the registrant's balance sheet, a registrant should include that amount in the "Less than 1 year" column of its contractual obligations table. Similarly, the contractual obligations table should include any noncurrent FIN 48 liabilities for which the registrant can make a reasonable estimate of the amount and period of related future payments (e.g., uncertain tax positions subject to an ongoing examination by the respective taxing authority for which settlement is expected to occur beyond the next operating cycle). However, there is often a high degree of uncertainty regarding the timing of future cash outflows associated with some FIN 48 liabilities, and, in those cases, a registrant might be unable to make reasonable estimates of the period of cash settlement with the respective taxing authority (e.g., unrecognized tax benefits for which the statute of limitations might expire without examination by the respective taxing authority). A registrant could exclude from the table that component of the FIN 48 liability for which reasonable estimates cannot be made, or disclose such amounts within an "other" column added to the table. To the extent any FIN 48 liabilities are excluded from the contractual obligations table or included in an "other" column, a footnote to the table should disclose the amounts excluded and the basis for such exclusion.

Committee Recommendation: The Committee supports View C.

SEC Staff Response: The staff supports View C.

Question 2:

The table of contractual obligations included in the most recent Form 10-K might have included or excluded amounts related to income tax contingencies, as determined under the registrant's previous accounting policy. In the interim period of adoption of FIN 48, what MD&A disclosures are required related to the table of contractual obligations?

View A: The registrant should provide a complete table, if there are material differences from the table in the Form 10-K. MD&A in the first Form 10-Q reflecting the adoption of FIN 48 should update the table of contractual obligations for any material amounts related to FIN 48 liabilities (on a basis consistent with View C to Question 1).

View B: MD&A in the first Form 10-Q reflecting the adoption of FIN 48 should provide narrative disclosures regarding any material effects of FIN 48 liabilities on the table of contractual obligations.

View C: None. Interim MD&A rules only require disclosure of “material changes outside the ordinary course of the registrant’s business in the specified contractual obligations during the interim period.” The adoption of FIN 48 does not represent a material change in the underlying economic exposure from uncertain tax positions, only the way in which the related liability is recognized and measured. Accordingly, no interim MD&A disclosure would be required absent a material change, outside the ordinary course of business, in the liability for unrecognized tax benefits during the interim period.

Committee Recommendation: The Committee supports View C.

SEC Staff Response: The staff indicated they would accept either View A or B.