



U.S. Securities and Exchange Commission

Speech by SEC Staff: Remarks Before the 2006 AICPA National Conference on Current SEC and PCAOB Developments

by

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The following is a summary of my remarks made at the 2006 AICPA National Conference on Current SEC and PCAOB Developments.

Presentation and Disclosure Requirements

Interim Period Disclosures

The disclosure requirements of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48)¹, are laid out in paragraphs 20 and 21 of the Interpretation. Paragraph 21 notes that the disclosures are to be provided at the end of each annual reporting period. The SEC staff was asked by members of the AICPA's SEC Regulations Committee about its views as to what disclosures related to FIN 48 a public company should make in its Form 10-Q in the period of adoption.

Under Rule 10-01(a)(5) of Regulation S-X, the SEC staff typically requires that, if a new accounting pronouncement is adopted during an interim period, all of the disclosures required by that new accounting pronouncement be provided in the interim period financial statements and continue to be provided in each subsequent interim period until annual financial statements are filed on Form 10-K. In considering FIN 48's disclosure requirements, the SEC staff noted that for the tabular reconciliation of the total amounts of unrecognized tax benefits (described in paragraph 21(a) of FIN 48), it was

not the FASB's intent to require this roll-forward in interim periods and it may be burdensome for entities to provide it in interim periods. We therefore agreed with the AICPA's SEC Regulations Committee's view that this roll-forward need not be provided in the interim period in which FIN 48 is adopted. In subsequent interim periods before annual financial statements for the period are filed, registrants should disclose any material changes.²

Preferability of Presentation

Members of the AICPA's SEC Regulations Committee also had raised questions to the SEC staff about preferability letters related to adoption of FIN 48. In particular, if a public company changes its income statement classification of interest and/or penalties on income tax deficiencies in connection with the adoption of FIN 48, is a preferability letter required under Item 601(b)(18) of Regulation S-K?

To summarize the SEC staff's views in this area, acceptable classification alternatives for interest and penalties on income tax deficiencies existed prior to the issuance of FIN 48 and continue to exist after the issuance of FIN 48. Paragraph 19 of FIN 48 states that classification of interest and penalties should be based on the accounting policy election of the enterprise.³ Ordinarily in this type of situation, we would expect a preferability letter to be provided when a public company changes its income statement classification policy. However, because FIN 48 fundamentally changes the accounting model for uncertain tax positions and related interest, we do not see the need for a preferability letter in situations where, upon adoption of FIN 48, a public company changes its policy on income statement classification of interest and penalties on income tax deficiencies. In contrast, if a public company materially changes its income statement classification policy for interest and penalties after the adoption of FIN 48, we would expect the company to provide a preferability letter when that change is made.

Evidence and Documentation

It has come to our attention that some auditors and preparers are having difficulties making judgments about the sufficiency of the quantity and type of evidence and documentation needed to comply with FIN 48. In some cases, it appears that preparers do not have trouble gathering evidence related to the technical merits of their tax positions, but they have had differences with their auditors as to the quantity of, and level of detail provided in, their documentation of that evidence. In other cases, it appears that some preparers (for example, those in the mutual fund industry) are experiencing difficulties in gathering evidence that they believe complies with a narrow reading of paragraph 7 of FIN 48.

It is worth noting that FIN 48 does not provide prescriptive guidance on the quantity or type of documentation that must be maintained by an enterprise in order to comply with FIN 48's recognition (or measurement) provisions. In addition, FIN 48 does not place any limits on the type of evidence that an enterprise can look to in making its more-likely-than-not determination.

Reasonable judgments will need to be made in these areas. For example, it would not appear necessary for an enterprise to spend a lot of time preparing documentation to support tax positions that are widely accepted, as those generally would not be uncertain. In gathering evidence to support a more-likely-than-not determination, an enterprise should think about all of the sources of evidence available, which could include informal as well as formal guidance from the taxing authority and other sources, and then weigh the different pieces of evidence based on their persuasiveness. While I would certainly encourage preparers and their auditors to comply fully with FIN 48, I would also encourage them to focus on the principles in the Interpretation and not lose sight of reasonable judgment and common sense in its implementation.

Endnotes

¹ FIN 48 was issued in June 2006 and is an interpretation of FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 is effective for fiscal years beginning after December 15, 2006.

² See also the AICPA's Center for Public Company Audit Firm Alert #138, November 21, 2006.

³ FIN 48, paragraph 19 states: "Interest recognized in accordance with paragraph 15 of this Interpretation may be classified in the financial statements as either income taxes or interest expense, based on the accounting policy election of the enterprise. Penalties recognized in accordance with paragraph 16 of this Interpretation may be classified in the financial statements as either income taxes or another expense classification, based on the accounting policy election of the enterprise. Those elections shall be consistently applied."

<http://www.sec.gov/news/speech/2006/spch121306jmg.htm>