MINUTES

Financial Accounting Standards Board

To:	Board Members		
From:	Strange (ext 442) and Cowan (ext 233)		
Subject:	Minutes of the January 11, 2005, Board Meeting—Uncertain Tax Positions: Subsequent Recognition and Measurement, Change in Judgment, Interest and Penalties, Classification, Transition, and Effective Date	**Date:**	January 20, 2006
cc:	Smith, Bielstein, Leisenring, Project Team, Mahoney, Getz, Beswick, Geary, Gabriele, Carney, Polley, Petrone, McDonald, FASB Intranet, McGeachin (IASB), Upton (IASB)		

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

Topic: Uncertain Tax Positions: Subsequent Recognition and Measurement, Change in Judgment, Interest and Penalties, Classification, Transition, and Effective Date

Basis for Discussion: Board Memorandum No. 17 dated December 27, 2005

Length of Discussion: 9:00 a.m. to 10:15 a.m.

Attendance:

Board members present: Herz, Trott, Crooch, Schipper, Batavick, Seidman, and Young

Board members absent: None

Staff in charge of topic: Thomas

Other staff at Board table: Cassel, Smith, Strange, and Cowan

Outside participants: None

Summary of Decisions Reached:

At today's meeting, the Board decided:

1. On subsequent recognition and measurement that:
    a. The best estimate of recognized tax benefits at each reporting date would represent management's best estimate given the information available at the reporting date, even though the outcome of the tax position is not absolute or final.
    b. Subsequent recognition, derecognition, and measurement should be based on new information.
2. The guidance in APB Opinion No. 28, *Interim Financial Reporting*, and FASB Interpretation No. 18, *Accounting for Income Taxes in Interim Periods*, would apply in accounting for changes in judgments about the recognition and measurement of tax benefits during interim periods, unless other U.S. GAAP applies to the situation.
3. Disclosure issues will be addressed at a future Board meeting.
4. On interest and penalties:
    a. A liability for interest and/or penalties would be recognized as deemed to be incurred based on the provisions of the tax law, that is, the period for which the taxing authority would begin assessing interest and/or penalties.
    b. The amount of interest expense recognized will be based on the difference between the amount recognized in the financial statements and the benefit recognized in the tax return. That estimate will not consider examination risk.
    c. The final Interpretation will not provide guidance on the classification of interest or penalties in the income statement. Enterprises will be required to establish a policy for classification of such amounts, disclose that policy in the summary of significant accounting policies, and also disclose the amount of interest and penalties recognized in the financial statements.
5. The liability recognized pursuant to the final Interpretation would be classified as a current liability to the extent that cash payment is expected to occur within 12 months or the operating cycle, if longer.
6. The change in net assets as a result of applying the provisions of the final Interpretation will be considered a change in accounting principle with the cumulative effect of the change treated as an

offsetting adjustment to the opening balance of retained earnings in the period of transition.

7. The final Interpretation will be effective as of the beginning of the first annual period beginning after December 15, 2006. Early application is encouraged provided the entity has not publicly released financial statements for the period of initial application.

Objective of Meeting:

The meeting's objective was for the Board to re-deliberate the following issues:

a) Subsequent recognition and measurement
b) Change in judgment
c) Interest and penalties
d) Classification
e) Transition and effective date.

The objective of the meeting was met.

Matters Discussed and Decisions Reached:

1. Mr. Thomas began by stating that the Exposure Draft on uncertain tax positions indicated that an external event was not necessary for subsequent recognition and/or measurement of a tax benefit. The Exposure Draft did not represent the Board or staff's view that an external event would not generally be the catalyst for subsequent recognition and measurement, rather, the Exposure Draft represents the view that evidence in disputes with taxing authorities are not easily verifiable. However, in researching the issue for redeliberations, the staff began to believe the most important issue for reconsideration was whether or not there was a need for an enterprise to establish certainty or finality of an issue (for example, a dispute with taxing authorities about a tax position) before subsequent recognition or measurement of an uncertain tax position could occur. The staff believed that the subsequent recognition and measurement of an uncertain tax position should be based on management's best estimate at the reporting date, whether or not there is absolute certainty or finality on the issue. Additionally, changes in recognition or measurement should not be based on gradual shifts in judgment about a tax position.
2. Ms. Seidman supported the staff's recommendation stating that wording in the final Interpretation should reflect the need for new information before

subsequent recognition and measurement, and should be similar to the language used in the change in accounting estimate under GAAP, such as in APB Opinion No. 20, *Accounting Changes*. Mr. Crooch also supported the staff's recommendation provided that the final Interpretation includes clearer language.

3. Ms. Schipper supported the staff's recommendation, noting that the recommendation asks what conditions need to be met for a change in recognition or a change in measurement. Ms. Schipper stated her understanding of the staff's recommendation was that an enterprise must have new information prior to subsequent recognition, derecognition, or measurement, but not necessarily a resolution of all uncertainty. Ms. Schipper stated that a different assessment of the same information is not sufficient and that there needs to be new information.
4. Mr. Batavick supported the staff's recommendation stating that the tax area is very fluid and judgment based on information is required to provide the best estimate. Using the staff's suggestion along with the revised language mentioned by Ms. Seidman will give the best estimate for financial reporting. The Board unanimously supported the staff's recommendation.
5. Mr. Thomas presented the next topic, change in judgment, stating that the Exposure Draft analogized to paragraph 194 of FASB Statement No. 109, *Accounting for Income Taxes,* for change in judgment in interim periods. Additionally, the Exposure Draft indicated that both *in- period* and *out-of-period* changes in judgment should be accounted for as discrete items. Based on comment letter responses and subsequent research, the staff recommends that interim accounting in the final Interpretation follow Opinion 28 and Interpretation 18.
6. Mr. Trott disagreed with the staff's recommendation. He prefers to maintain the approach outlined in the Exposure Draft because he believes that there are discrete events that occur. However, Mr. Trott stated that he would not object to the staff's recommendation if the final Interpretation mentions the application of footnote 2 of paragraph 20 in Opinion 28. He further expressed that there may be practical difficulties in separating prior period changes from

current period changes because prior period changes impact the current period. Mr. Crooch also preferred the Exposure Draft approach but said he would not object to the staff's recommendation.

7. Mr. Young supported the staff's recommendation noting that it would ease the understanding of users if they treated uncertain tax positions similar to estimates of taxes under Opinion 28. Mr. Young also stated that he does not object to additional disclosures as mentioned by Mr. Trott. The staff's recommendation would be easier for users to understand as it distinguishes between in-period and out-of-period items following an Opinion 28 approach.
8. Mr. Batavick supported the staff's recommendation because when evaluating taxes users look at taxes on a yearly basis. If there are changes in estimates for current items within the current year, these changes should be reflected in the current year so they impact the effective tax rate. Under this approach, taxes for the current year could stand alone. For changes in best estimates for prior year items there are discrete events that should be recorded in the quarter when they are noted.
9. Ms. Seidman also supported the staff's recommendation, explaining that treating all items with the same approach is not appropriate, and that even the in-period or out-of-period question is not an issue that can be addressed with one approach. Ms. Seidman clarified that within Opinion 28 there are several approaches as to how to treat items that are different in nature. Ms. Seidman reiterated that she generally supports the staff's recommendation, but she would like to see further analysis on other GAAP that may proscribe specific treatment for certain types of items. Ms. Seidman summarized her comments by stating we should analogize to or follow Opinion 28 and its related interpretations except when other specific GAAP provides guidance on how to handle certain items for interim reporting periods. Mr. Herz supported Ms. Seidman's position that other GAAP should be considered.
10. Ms. Schipper stated that she agreed with the proposals in the Exposure Draft, however, she would not object to the staff's recommendation as long as it explicitly includes the disclosures mentioned by Mr. Trott and presents information that would make clear the effects of changes in judgment. That

is, if changes in judgment impact the current period the effective tax rate would be revised and a catch-up adjustment or proportional recognition for current items would be recognized. Changes in judgment regarding prior periods would be fully recognized in the current period. Mr. Herz also supported the staff's recommendation with the enhancements put forward by the other Board members.

11. Four Board members voted in favor of the staff's recommendation that the final Interpretation will indicate the guidance in paragraphs 19 and 20 of Opinion 28, and Interpretation 18 should be followed for changes in judgments about tax positions (DMY, GJB, LFS, RHH). Three Board members preferred to retain the Exposure Draft's approach (EWT, GMC, KAS).
12. Mr. Thomas explained that based on the Board's discussion of the staff analysis in the Board memorandum, disclosures would not be addressed at today's Board meeting, but that the staff would further research the issue to bring to the Board at a future meeting.
13. Ms. Strange introduced the topic of interest and penalties to the Board by stating that the staff had three questions for the Board. The three question topics were as follows:
    a. The recognition of interest and penalties
    b. The amount of interest expense to recognize
    c. The classification of interest and penalties.
14. Ms. Strange addressed the first question by stating that the recognition of interest and penalties centers around two alternatives which are to: (a) recognize interest and penalties when incurred according to relevant tax law (that is, the period in which the tax position is recognized in the financial statements), or (b) recognize interest and penalties only after they have been assessed by the relevant taxing authority.
15. In response to a question by Mr. Trott, Mr. Thomas explained that *incurred* in this context relates to the staff's recommendation that interest and penalties should be recognized in the same period in which the interest would be computed on the amounts outstanding based on the provisions of the tax law.

The staff understands that interest and/or penalties are required as of the date estimated tax payments are required to be paid in certain jurisdictions. The financial statements should reflect interest in the period that it would begin accruing, according to the relevant tax law, and penalties in the period that they would first be assessed, according to the relevant tax law.

16. Mr. Young asked if the staff's recommendation was implying recognition before there was a legal obligation. Mr. Trott responded that interest and penalties were being handled consistent with accrual accounting. The Board unanimously supported the staff's recommendation to accrue interest and/or penalties in the period the interest and/or penalties are incurred, based on the provisions of the relevant tax law.
17. Ms. Strange presented the second question on interest and penalties regarding the amount of interest to accrue. She explained that the Exposure Draft proposed accruing interest based on the entire difference between the tax position in the financial statements and the tax position on the tax return. The staff's recommendation was to accrue the interest based on management's best estimate of the amount that will ultimately be paid to the taxing authority upon settlement. Examination risk would not be considered when arriving at this best estimate.
18. Mr. Batavick supported the staff's recommendation saying that it would provide a more representationally faithful amount to users. Going with the Exposure Draft approach overstates the interest amount. Additionally, the Interpretation has a best estimate approach in general, and, therefore, it is more consistent to use best estimate for interest as well.
19. Mr. Crooch and Mr. Trott disagreed with the staff's recommendation, and prefer the Exposure Draft's approach. Ms. Seidman also supported the Exposure Draft's approach rather than the staff's recommendation. Ms. Seidman stated that for items that meet the more-likely-than-not threshold she believes the interest and/or penalties should be based on the best estimate. She also believes that for items that do not meet the more-likely–than-not recognition threshold for the financial statements, the amount of interest and/or penalties should be based on the full amount of the tax

position (that is, the Exposure Draft approach). Ms. Seidman explained her reasoning for this approach is that if a two-step approach is used for recognition in the financial statements, it does not make sense to use a different approach for recognition of interest and/or penalties. If one uses a best estimate approach for items that do not meet the threshold there will be no correlation between the interest and/or penalties recognized and the liability recorded in the financial statements. Ms. Schipper disagreed with the staff's recommendation, stating that her views paralleled the views of Ms. Seidman.

20. Mr. Young also supported the staff's recommendation because it would provide more relevant and representationally faithful information to users, regardless of whether or not the tax position meets the more-likely-than-not threshold for financial statement recognition. Management's best estimate of the amount provides the best information. Mr. Herz agreed with the staff's recommendation.

21. Four Board members voted for the approach outlined in the Exposure Draft. That is, interest will be accrued based on the difference between the tax position in the tax return and the tax position recognized in the financial statements (EWT, GMC, LFS, KAS). Three Board members supported the staff's recommendation (DMY, GJB, RHH).

22. Ms. Strange then indicated the staff's recommendation on classification of interest and penalties was to treat classification of interest and penalties as a policy election, disclose the policy election in the financial statements, and disclosure as to the amounts of interest and/or penalties recognized in the financial statements. The Board unanimously agreed to the staff's recommendation.

23. Mr. Thomas opened the discussion on classification of amounts recognized by applying the guidance of this Interpretation by explaining two alternative treatments. The first alternative is the Exposure Draft approach, which indicates that liabilities arising from the difference between the tax position and the amount recognized and measured pursuant to the Interpretation, should be classified as a current liability for the amounts anticipated to be

paid within one year or the operating cycle, if longer. The second alternative is an approach based on ARB No. 43, Chapter 3A, "Working Capital—Current Assets and Current Liabilities," which states that the income tax liability should be considered a current liability. Mr. Thomas also indicated that there is some diversity in views among the staff whether ARB 43, Chapter 3A applies to all tax liabilities, or simply to the *as filed* tax liability. Mr. Thomas indicated that the staff recommended the approach based on ARB 43, Chapter 3A where the income tax liability that arises from applying the Interpretation should be classified as a current liability.

24. Ms. Schipper and Mr. Crooch supported the staff's recommendation. Mr. Batavick disagreed with the staff's recommendation stating that the Exposure Draft's approach provided more relevant and representationally faithful information. When looking at an enterprise's liabilities, users are trying to assess liquidity and future cash flows. However, unnecessarily adding to current liabilities amounts that will not be paid in the next 12 months hinders the users' analysis. If the cash flow will occur in 12 months or the operating cycle it should be current, but anything longer should not. In response to a question from Ms. Schipper, Mr. Batavick stated that he believes management should estimate the timing of the cash flows and does not think it makes sense to unnecessarily add to current liabilities.
25. Mr. Trott disagreed with the staff's recommendation, and is in favor of the Exposure Draft's approach. Ms. Seidman also disagreed with the staff's recommendation stating that it is important to distinguish between the time when the liability is incurred and the timing of the cash flows associated with the liability.
26. Mr. Young disagreed with the staff's recommendation. Users expect current liabilities to relate to the operating cycle. To put something that management can reliably forecast as occurring in five or six years in current liabilities is misleading to the users of financial information. There is a legal obligation to the taxing authority that is current, but the timing of the cash flow is more relevant to the users than the legal categorization. For the users' benefit and

for relevant information in forecasting future cash flows to ignore the timing of those cash flows and the payment to the taxing authorities is misleading.

27. Mr. Trott noted that in practice, uncertainty is being handled both ways and this issue should be addressed in the financial performance reporting project. Further, he agreed with the Exposure Draft’s approach because this issue would be dealt with in a more comprehensive way in the future.

28. Five Board members voted to maintain the Exposure Draft’s approach wherein the difference between the tax position and the amount recognized in the financial statements is a current liability if it is anticipated that the amount will be paid within one year or the operating cycle, if longer (GJB, EWT, DMY, LFS, RHH). Two Board members supported the staff’s recommendation (KAS, GMC).

29. Ms. Strange presented the topic of transition to the Board by stating the Exposure Draft prescribed transition as a cumulative effect of a change in accounting principle. However, as a result of the issuance of FASB Statement No. 154, *Accounting Changes and Error Corrections,* the cumulative effect of applying the Interpretation would be treated as an adjustment to the opening balance of retained earnings. Ms. Strange indicated that the Board’s conclusions to prohibit retroactive restatement in the Exposure Draft were similar to the rationale in Statement 154 about the inappropriate application of hindsight. Ms. Strange indicated that the staff recommends transition through a cumulative effect adjustment as an adjustment to the opening balance of retained earnings, in accordance with Statement 154. Further, that retrospective application should be prohibited.

30. Mr. Batavick supported the staff’s recommendation, but expressed concern about telling preparers that they cannot retrospectively apply guidance due to impracticability. He stated that preparers are in a better position to assess the practicability of applying guidance than the Board.

31. Ms. Schipper stated that the Exposure Draft’s approach was not that businesses are not able to apply the guidance due to impracticability. Many enterprises would be able to put together the information that would allow them to do a retrospective application. However, that information would be

tainted by hindsight bias as described in Statement 154. That is, the inability to separate what one knows now from what one would have known then had one been applying this standard that did not exist at the time.

32. Mr. Young disagreed with the staff's recommendation, and asked what was wrong with revising past information using hindsight. Mr. Young stated his belief that retrospective application would provide more relevant information in the financial statements. At a minimum there should be an option to choose retrospective application.

33. Six Board members voted in favor of the staff's recommendation to treat the transition as a cumulative change in accounting principle, consistent with Statement 154, recognizing any adjustment to net assets as an adjustment to the beginning balance of retained earnings in the period of transition (RHH, GMC, GJB, EWT, LFS, KAS). One Board member disagreed with the staff's recommendation (DMY). Mr. Herz noted that the points brought up by Mr. Young and Mr. Batavick are broader questions that the Board should be thinking about.

34. Ms. Strange presented the staff's recommendation on the effective date of the Interpretation by stating that the staff expected to finish the Interpretation by March or April of 2006. However, even if the final Interpretation is not issued until June 2006, the staff's recommendation would provide preparers with ample time to apply the Interpretation based comments received in the comment letters. Ms. Strange indicated that the staff recommends that the final Interpretation be effective in the first annual period beginning after December 15, 2006, and that early adoption be encouraged, provided that the enterprise has not already publicly released financial statements in the period of adoption.

35. Mr. Trott and Mr. Young agreed with the staff's recommendation. Ms. Seidman also agreed with the staff's recommendation noting that it would provide for a cleaner application with respect to interim items if there was an entire year of applying the Interpretation in the statements. The Board unanimously agreed with the staff's recommendation.

36. Mr. Young indicated that he planned to dissent on the final Interpretation because he disagreed with the Board's earlier tentative conclusions about examination risk. Mr. Herz indicated he was still considering whether or not he would dissent from the final Interpretation because of the recognition threshold the Board had earlier tentatively selected.

Follow-up Items:

None

General Announcements:

None