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FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes

Audit committees, boards, and others supporting the financial reporting process should be aware of the following development potentially affecting a company's financial statements and/or disclosures.

FASB Interpretation No. 48 (or FIN 48)* addresses how companies must treat—i.e., recognize, measure, and disclose—uncertain tax positions for financial reporting purposes.

Given the potential financial reporting implications of this requirement, boards and audit committees should understand management's plan to inventory the company's uncertain tax positions, the potential financial statement impact, and disclosure implications. Ultimately, the board and audit committee should be comfortable that management's FIN 48 compliance processes and conclusions are appropriate and sound.

The Issue

Under FIN 48, a company recognizes the tax benefit of a tax position for financial reporting purposes if it is "more likely than not" (more than 50 percent likely) that the tax position will be sustained on examination. Some companies in the past provided for the recognition of tax positions only if sustainability were "probable"—guided, in part, by the views expressed by SEC staff; other companies applied different thresholds, which suggests a diversity of practices have been used.

If the "more likely than not" threshold is met, FIN 48 requires the company to measure the benefit as the largest amount that is more than 50 percent likely to be realized upon settlement with the taxing authority. Importantly, FIN 48 also specifies new disclosure requirements for unrecognized tax benefits.

FIN 48 is proving to be a major undertaking for some companies, depending on their past accounting policies for tax uncertainties, as it requires that they inventory and evaluate uncertain income tax positions related to open tax years in all jurisdictions (federal, state, local, and foreign), not just those arising after FIN 48's effective date—fiscal years beginning after December 15, 2006.

Considerations for Audit Committees and Boards

Among other considerations in their oversight of the company's response to FIN 48, boards and audit committees should understand that FIN 48:

- Will impact most companies in the first quarter of 2007
- Will involve a process that requires conclusions about the technical merits of its tax positions and the measurements of the related benefits, if any
- May require considerable time and effort by the company's tax and financial management teams, depending on the company's prior accounting policies
- Will require significant annual disclosures in the footnotes to the financial statements.

Boards and audit committees should have a good understanding of:

- The potential impact of FIN 48 on financial statements and related disclosures
- Management's plan to inventory, and the process to evaluate, uncertain tax positions, including the quality of its "more-likely-than-not" determinations and related measurements, if any
- Management's ability to establish a sustainable compliance program
- Implications of potential disclosures.

FIN 48 At-a-Glance

- Specifies new disclosure requirements with regard to unrecognized tax benefits.
- May require substantial efforts by management's financial team.
- Establishes a threshold that must be met to recognize tax benefits of tax positions for financial reporting purposes ("more likely than not").
- Requires companies to inventory and evaluate uncertain tax positions—not just those arising after the effective date—in all jurisdictions.
- Effective for fiscal years beginning after December 15, 2006.

Additional Resources

See KPMG's *Defining Issues* No. 06-21, Accounting for Income Tax Uncertainties, July 2006 (www.kpmg.com/aci/docs/DI_06_21_TaxUncertainties.pdf).

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* FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109.