

MINUTES



To: Board Members
From: Strange (ext. 442) and Cowan (ext. 233)
Subject: Minutes of the March 1, 2006, Board Meeting—Uncertain Tax Positions: Measurement Issues **Date:** March 9, 2006
cc: Smith, Bielstein, MacDonald, Leisenring, Project Team, Mahoney, Sutay, Beswick, Geary, Gabriele, Carney, Polley, Petrone, FASB Intranet, McGeachin (IASB), Upton (IASB)

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Topic: Uncertain Tax Positions: Measurement Issues—Application of the Best Estimate Measurement Attribute

Basis for Discussion: Board Memorandum No. 18
Dated February 8, 2006

Length of Discussion: 1:25 p.m. to 2:00 p.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: Smith, Golden, Strange, and Cowan

Outside participants: None

Summary of Decisions Reached:

At today's meeting, the Board decided:

1. That the measurement attribute for the amount of recognized tax benefit should be the maximum amount which is more-likely-than-not to be realized.

Objective of Meeting:

The meeting's objective was to update the Board on the activities of the IASB related to the uncertain tax positions project and to reconsider the Board's decision on a measurement attribute. The objective of the meeting was met.

Matters Discussed and Decisions Reached:

1. Mr. Thomas began by stating that the Board's tentative decisions include a two-step approach for recognition and measurement. First, a tax position must meet a more-likely-than-not recognition threshold based solely on its technical merits, presuming the tax position will be audited by the taxing authority. Second, the position must be measured at its *best estimate*, as the term is used in Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, to mean the single most likely amount from a range of possible estimated amounts.
2. Mr. Thomas explained that the Board had received two comment letters since its decision on a best estimate measurement attribute indicating that counterintuitive results may occur by using that attribute. While the staff believes these outcomes are not likely, it prepared a memorandum to illustrate the application of the Board's decision in comparison to various other alternatives for measurement. The purpose of this comparison was to affirm the Board's understanding of its tentative decision to use the best estimate measurement attribute. The memorandum focused primarily on scenarios similar to those brought up in the unsolicited comment letters.
3. Mr. Thomas stated that he presented the Board's tentative decisions on the uncertain tax positions project to the IASB at its February meeting. The IASB's current, unexposed approach to uncertain tax positions uses an

expected outcome, which is essentially an expected value measurement assuming examination and without considering the time value of money. Mr. Thomas clarified that when he used the term expected value he was referring to the sum of the probability-weighted amounts in a range of possible estimated amounts.

4. Additionally, Mr. Thomas explained that while the expected outcome approach has not yet been exposed for public comment in connection with IAS 12, *Income Taxes*, the IASB has begun redeliberations on the Exposure Draft that would amend IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, to require the use of expected value. Mr. Thomas noted that the IASB Board recently affirmed its decision to use the expected outcome approach in IAS 12 at its February meeting with full knowledge of the reaction to expected value that arose in the comment letters for the amendments to IAS 37.
5. Mr. Thomas stated that the staff was not prepared to make a recommendation on the expected outcome approach to the Board, but he further stated that some staff members are leaning towards an expected outcome approach and that a majority of staff members believe additional research is necessary if the Board is attracted to that approach. The needed research would likely take several weeks before the staff could present its recommendations concerning an expected outcome approach.
6. Mr. Thomas introduced memorandum number 18, which presented an analysis of three measurement alternatives: (a) a best estimate, consistent with Concepts Statement 7, (b) a bounded best estimate, or cumulative probability, where the largest number that is cumulatively at least more-likely-than-not will be recognized, and (c) an expected outcome. The first two approaches address recognition and measurement in two steps (which reflect the Board's current decision). In contrast, the expected outcome approach addresses all uncertainty through measurement.

7. Mr. Thomas asked the Board if it wanted to:
 - a. Affirm the tentative decisions to date to use a recognition threshold coupled with a best estimate measurement (the single most likely amount)
 - b. Affirm the more-likely-than-not recognition threshold while measuring the benefit at a cumulative probability of more-likely-than-not (for example, the largest benefit that is at least more-likely-than-not)
 - c. Direct the staff to perform additional research on the application of an expected outcome approach in accounting for income taxes (which would converge to the IASB's tentative decision) and bring a recommendation for the Board's consideration at a later date.
8. Mr. Crooch asked Mr. Thomas why it would take the staff so long to evaluate the IASB's expected outcome approach. In response, Mr. Thomas explained that the staff wants to ensure it has adequate feedback from a variety of constituents, which is why it would need a longer than normal evaluation period. This may result in some education of constituents about expected value. To date, the staff only has had conversations with two large preparers who said that the expected outcome approach would be practicable for them and that they generally would be comfortable with expected value.
9. Ms. Seidman stated that IAS 37 does not apply to taxes and that the expected outcome approach for income taxes has not been exposed for comment. Mr. Thomas concurred with Ms. Seidman. However, he emphasized that the IASB has recently concluded the comment period on IAS 37 and has affirmed the decision to use expected value in income taxes with full knowledge of the comments on expected value in IAS 37.
10. Ms. Schipper stated that the FASB and the IASB Boards announced their desire to converge IAS 12 and FASB Statement No. 109, *Accounting for Income Taxes*. A failure to resolve the measurement issue in a convergent way would subvert the goal of eliminating reconciling tax items. Messrs. Golden, Smith, and Thomas agreed with Ms. Schipper that there cannot be elimination of reconciling tax items when there is a structural difference between recognition and measurement.

11. Ms. Seidman stated that she would like to see an inventory of the differences between Statement 109 and IAS 12 that the Board decided not to address because of fundamental differences. She explained that she did not want to make uncertain tax positions a higher priority than other fundamental tax differences that the Board chose not to include in the scope of the tax convergence project. Mr. Thomas stated that leveraged leases were not being addressed since IFRS does not have a similar concept. Business combinations and share-based payments were not addressed because they were already being addressed in other projects. Mr. Crooch said that he wanted to converge with the IASB on a measurement attribute but was unsure of the likelihood of expected outcome ultimately being used in IAS 12 given the uncertainty of the IASB's position and the difficulty for constituents in applying an expected outcome approach.
12. Mr. Smith noted that the project's initial objective, at the request of the SEC, was to reduce the diversity in practice in accounting for uncertain tax positions. Mr. Crooch stated that while he would like to converge with the IASB on a measurement attribute, at this time it is more important to move forward on the uncertain tax positions project. For this reason he supported a bounded best estimate approach.
13. Mr. Trott stated that the FASB cannot converge on a measurement attribute since the IASB's decisions are tentative and have not been exposed for comment with regard to IAS 12. Mr. Trott expressed concern about the amount of time and effort that the IASB will need to enable constituents to more fully understand and be able to apply expected outcome to taxes. Mr. Trott stated that the responses to the IAS 37 amendments Exposure Draft revealed a misunderstanding of the standard on the part of constituents. Mr. Trott explained that constituents are not applying expected value in the context of IAS 37.
14. Ms. Seidman stated that the follow-up comment letters convinced her of the possibility of inappropriate reporting without the presence of a recognition threshold and a bounded dispersion. She expressed her support for the bounded best estimate and explained that alternative 3, the expected

outcome approach, would have several consequences. First, the proposed Interpretation would need to be re-exposed. Second, the leveraged leases project's effective date is linked to the uncertain tax positions project and any delay for uncertain tax positions would delay leveraged leases unless the two were no longer linked. Finally, selecting the expected outcome approach would essentially start the uncertain tax positions project again. Ms. Seidman clarified that she preferred to move ahead with the bounded best estimate approach as an interim improvement and deal with convergence at a later time, if or when the IASB proceeds with the expected outcome approach.

15. Mr. Young said that he supports the expected outcome approach because he believes it is more operational. A two-step measurement approach separates outcome probability assessments from measurement. He believes the two are interrelated and must be combined to be operational. Mr. Trott stated that he supports the bounded best estimate approach.

16. Ms. Schipper stated that she understands the pragmatic considerations as outlined by Ms. Seidman. She stated that the Board seems to be indicating that uncertain tax positions are unique compared to other places in U.S. GAAP where the Board requires preparers to take into account a distribution of possible outcomes. She further stated that unlike business combinations there are not transaction amounts that bound the outcomes and unlike guarantees and asset retirement obligations uncertain tax positions are not simply liabilities. Ms. Schipper questioned whether the absence or presence of a transaction or whether an item is an asset or a liability should change the measurement from one which takes into account the entire distribution of outcomes. Ms. Schipper asserted that the Board should base its decision on the technical merits of a measurement approach. Information about practical considerations, such as whether preparers and auditors have the requisite expertise to apply an expected outcome approach, will be received in the comment letter phase. Ms. Schipper then stated that she supports an expected outcome approach since it is the conceptually superior answer. However, she will not dissent to the use of a bounded best estimate approach that takes at least some of the distribution of possible outcomes into account.

17. Mr. Batavick noted that the Board had exhaustively debated measurement attributes and that the Board's method had been accepted by constituents. (Only a small minority of respondents to the Exposure Draft suggested that the Board use an expected outcome approach.) He stated that he did not share the concerns of other Board and staff members about using a strict best estimate approach and getting anomalous results. Mr. Batavick stated that he expected the bounded best estimate and the best estimate approaches to yield the same results in practice and, as such, he supported the bounded best estimate approach, providing that the terminology included the use of best estimate since constituents are now familiar with that term.
18. Mr. Herz stated that while he would like to converge on a measurement attribute, at this point it is impractical since the outcome of the IASB's deliberations regarding taxes is uncertain. Instead, Mr. Herz supported the bounded best estimate approach.
19. Mr. Herz summarized that five Board members supported the largest amount of tax benefit that is cumulatively more-likely-than-not (RHH, GJB, GMC, LFS, and EWT); that one Board member supported the expected outcome approach, but would not object to using the largest amount of tax benefit that is cumulatively more-likely-than-not to be realized (KAS); and that one Board member supported the expected outcome approach and might object to any other approach (DMY).

Follow-Up Items:

20. None

General Announcements:

21. None