Financial Accounting Standards Board
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LESLIE F. SEIDMAN
Chairman

March 20, 2012

Mr. Jeffrey J. Diermeier
Mr. Edward M. Harrington
Co-Chairs, Standard-Setting Process Oversight Committee
Financial Accounting Foundation
401 Merritt 7
Norwalk, CT 06856-5116

Messrs. Diermeier and Harrington:

The Financial Accounting Standards Board (FASB) is pleased to provide the accompanying response to the Financial Accounting Foundation's *Post-Implementation Review (PIR) Report on FASB Interpretation No. (FIN) 48, Accounting for Uncertainty in Income Taxes* (the PIR Report), dated January 2012.

Post-implementation reviews are an important feedback mechanism, providing insights into the effectiveness of our standards and opportunities to improve the standards-setting process. The Foundation's PIR process complements the FASB's on-going process of regular monitoring to identify issues encountered during the implementation of standards or arising from changing circumstances. The PIR process also provides important stakeholder feedback on the benefits and costs of a standard in light of actual experience in using and preparing the information. The establishment of a PIR process is responsive to the recommendation of the Advisory Committee on Improvements to Financial Reporting to the U.S. Securities and Exchange Commission, dated August 2008, that a formalized post-adoption review should be completed for significant new standards. A PIR may also identify ways the FASB might improve the effectiveness, efficiency, or transparency of the standards-setting process.

The FASB evaluates PIR Report findings following the review procedures in the *FASB Rules of Procedure* (Section IV.H.5) that lay out criteria for the review or reexamination of existing standards. Under those criteria, review or re-examination of existing standards might be indicated if information or evidence is obtained that had not previously or adequately been considered by the Board, such as evidence that the transactions or the environment have changed significantly since the standards were issued, that there have been consequences or costs that differ significantly from the Board's expectations, or that investors and other users broadly do not find the information useful. Those criteria are designed to ensure that the financial reporting system is not unduly burdened by the cost of frequent changes to accounting requirements.

The accompanying response explains the FASB's evaluation of the PIR Report in light of those review procedures. It also explains how the FASB plans to respond to the helpful process recommendations included in the Report. In summary, the FASB welcomes the recommendations to continue to improve our processes and we are taking steps to make enhancements in those areas. Because the findings in the Report indicate that overall, FIN 48 has improved the consistency, comparability and relevance of information about uncertain tax positions, and that those benefits outweigh the related costs, the FASB does not plan to undertake a separate project to review FIN 48 at this time. However, the FASB will consider the findings that are technical in nature in future efforts to simplify our standards, converge them with International Financial Reporting Standards, or both.

On behalf of the FASB, I would like to thank the Foundation for undertaking this important process and all of the individuals and organizations that gave their time to share their insights and experiences with the PIR review staff.

Sincerely,

Leslie F. Seidman

cc: FAF Board of Trustees

Post-Implementation Review Report on FASB Interpretation No. 48, ***Accounting for Uncertainty in Income Taxes***

Response of the Financial Accounting Standards Board

March 2012

Introduction

The FASB is pleased to respond to the Financial Accounting Foundation's *Post-Implementation Review (PIR) Report on FASB Interpretation No. (FIN) 48, Accounting for Uncertainty in Income Taxes* (the PIR Report), dated January 2012. This response explains:

a. The Board's process for evaluating PIR Report findings
b. The Board's consideration of the PIR findings relating to FIN 48 and its conclusions regarding the need for additional standards-setting action; and
c. The Board's plans for responding to the four specific process-related recommendations contained in the PIR Report on FIN 48.

Evaluating PIR Findings

Post-implementation reviews are an important feedback mechanism, providing insights into the effectiveness of our standards and opportunities to improve the standards-setting process. The Foundation's PIR process complements the FASB's ongoing process of regular monitoring to identify issues encountered in the implementation of standards or arising from changing transactions or circumstances. The PIR process provides the Board with important stakeholder feedback on the benefits and costs of a standard in light of actual experience in using and preparing the information. The process may also identify ways the FASB might improve the effectiveness, efficiency, or transparency of the standards setting process.

The FASB evaluated the PIR Report findings following the review procedures in the *FASB Rules of Procedure* (Section IV.H.5) that lay out criteria for the review or reexamination of existing standards. Under those criteria, review or re-examination of existing standards might be indicated if information or evidence is obtained that had not previously or adequately been considered by the Board, such as evidence that the transactions or the environment have changed significantly since the standards were issued, that there have been consequences or costs that differ significantly from the Board's expectations, or that investors and other users broadly do not find the information useful. Those criteria were designed to ensure that the financial reporting system is not unduly burdened by the system-wide cost of frequent changes in accounting requirements.

Background Regarding the Development of FIN 48

In 2004, the U.S. Securities and Exchange Commission's Office of the Chief Accountant informed the FASB of diversity in practice in accounting for uncertainty in income taxes. The FASB conducted additional outreach, receiving similar feedback from practitioners and companies that said several different methods had developed in practice because U.S. GAAP did not address how the uncertainty about whether a position taken on a tax return would be upheld should affect the amounts reported in the financial statements. After affirming the existence of diverse practices, the FASB added the FIN 48 project to its technical agenda with the objective of developing a recognition and measurement framework that would promote consistency in the reporting of uncertain tax positions. The Board issued an Interpretation in June 2006, which was effective for fiscal years beginning after December 15, 2006.

Through its monitoring of the implementation of FIN 48, the Board became aware of the need to clarify aspects of FIN 48. In May 2007, the Board issued a FASB Staff Position clarifying the term *settlement* as used in FIN 48. In response to concerns raised by the Private Company Financial Reporting Committee and others, the FASB deferred the effective date of FIN 48 for nonpublic entities so that (a) nonpublic entities would have more time to study and prepare to apply the requirements and (b) the FASB could provide additional guidance clarifying how FIN 48 applied to pass-through entities and not-for-profit organizations. FIN 48's requirements became applicable to nonpublic entities in fiscal years beginning after December 15, 2008. In early 2010, the Board also made relatively minor technical corrections to aspects of FIN 48's guidance. Since that time, we have not received any other stakeholder requests for additional authoritative implementation guidance.

Need for Standards-Setting Action

We believe that the PIR Report findings affirm the overall effectiveness of FIN 48. In particular, the stakeholder feedback indicates that (a) FIN 48 achieves its objective of more consistent recognition and measurement of uncertain tax positions, (b) reported information about income tax uncertainties is more relevant since FIN 48 was issued, and (c) most preparers did not incur significant incremental implementation and continuing compliance costs.

Notwithstanding these overall positive findings, the PIR Report relays concerns expressed by some preparers and practitioners about certain technical provisions that are central to FIN 48. In particular, some preparers and practitioners expressed concerns that the judgments required to recognize and measure income tax uncertainties under FIN 48 result in information that is not comparable and reported liabilities that may be larger than settled amounts because the risk of examination of tax uncertainties by authorities (so-called examination risk) is not considered and the selected recognition threshold. As set forth in its Rules of Procedure, the Board evaluated whether those concerns provided information or circumstances that were new or not adequately considered at the time FIN 48 was developed.

The approach under FIN 48 requires reporting entities to presume that each uncertain tax position will be evaluated on its technical merits assuming that the taxing authorities have full knowledge of the facts and issues. Examination risk was a central issue in the deliberations that led to FIN 48. The Exposure Draft highlighted this matter by specifically asking for feedback on it. Paragraphs B17–B22 of FIN 48 describe the various reasons why the Board concluded that FIN 48 should presume a tax position will be examined by the taxing authorities. That decision was based in part on the belief that a tax position that would not be upheld if examined does not change the fundamental nature of an obligation that was otherwise determined under the tax code (based on the definition of a liability in Concepts Statement 6). Some Board members believed that basing the accounting on examination risk was analogous to reporting accounts payable based not on the amounts owed, but on the amount that would ultimately be paid if the creditor filed suit to collect the liability. In addition, the FASB considered the views of respondents to the Exposure Draft who reasoned that considering examination risk is fundamentally inconsistent with a voluntary compliance tax system such as the one in the U.S. and that the possibility a position will not be examined is not relevant in determining if a tax position qualifies for financial statement recognition.

The PIR Report's findings also indicate that some preparers are concerned that the judgments required to recognize and measure income tax uncertainties result in information that is not comparable. The FASB acknowledges that significant judgment is required to apply both the recognition and the measurement provisions of FIN 48 and that the resulting information might not be comparable if entities reach different judgments. No approach to accounting for tax uncertainties can eliminate the judgment involved in interpreting and applying the tax code. The FASB concluded in FIN 48 that providing a recognition and measurement framework that can be applied consistently by reporting entities would increase the comparability of reported information about uncertain tax positions relative to the diverse practices at the time, a primary objective of the project. Indeed, the PIR Report findings indicate that investors and other users believe that income tax uncertainties are determined more consistently and are more comparable across reporting entities since FIN 48 was issued.

The PIR report findings indicate that some preparers and practitioners think that reported liabilities are larger than settled amounts, in part because no value is given to uncertain tax positions that fail to meet the more-likely-than-not (MLTN) recognition threshold. As described in paragraphs B29–B34 of FIN 48, the Board considered a variety of different recognition thresholds, ranging from a minimum statutory threshold to a probable threshold. The Board concluded that the MLTN threshold would provide greater comparability and operationality than other alternatives and that it would more faithfully represent the amounts that would be realized than the other possible thresholds.

The Board appreciates that there are different points of view about these issues and that some might have weighed the elements of this decision differently. However, the Board believes that the concerns discussed above were carefully considered during the development of FIN 48. The PIR Report was also discussed informally with several stakeholders, including members of FASB advisory groups. On the basis of those procedures, the Board has concluded that the criteria for a review or reconsideration of these fundamental aspects of FIN 48 are not met, and no discrete standards-setting action will be undertaken at this time. The FASB does plan, however, to consider the PIR Report findings, among other information, in its review of (a) whether differences or simplifications are appropriate for private companies (and potentially, for all entities) and (b) remaining differences between U.S. GAAP and International Financial Reporting Standards (IFRSs), in particular, IAS 12, *Income Taxes*. Any standards-setting activities arising from those efforts would be subject to the Board's robust due process procedures.

Process-Related Recommendations

As noted in the PIR Report, we had previously identified the need for improvement in some of the areas that are the focus of the process recommendations, particularly user outreach and cost-benefit considerations. In the years since FIN 48 was issued, we have been working continuously to expand and improve our procedures in those areas. Our current improvement efforts are focused on two aspects of the cost-benefit assessment. First, we believe that the extent and nature of stakeholder outreach needed to learn about benefits and costs should be scalable relative to (a) the magnitude of the potential impact of the change, (b) the importance of the issue from an investor perspective, and (c) potential implementation difficulty. We are currently cataloguing and evaluating existing outreach methods with the goal of developing guidelines to help FASB members and staff to consistently choose the outreach methods most appropriate for the nature of the issues and the stage of the project. We have undertaken a second initiative focused on improving the completeness and transparency of our communications about the Board's assessment of benefits and costs. The PIR Report recommendations will be a serious consideration in these ongoing improvement initiatives.

We plan to report to the Standard-Setting Process Oversight Committee of the Financial Accounting Foundation on the outcome of those initiatives.

Continue efforts to improve user input in agenda and early deliberation phases

The PIR Report recommends that the FASB continue its efforts to improve user input in the agenda and early deliberation phases so that the FASB understands users' perspectives as tentative decisions are reached.

The Board added FIN 48 to its technical agenda to develop a consistent method of accounting for uncertain tax positions. While we engaged users of financial statements in the project, we acknowledge their feedback was received primarily during the comment period and in the later stages of the project's development. At the time of the FIN 48 project, we were in the early stages of a longer term effort to improve the involvement of investors and other users in the standards-setting process. We believe that we have made significant progress in gathering user input since the time of the FIN 48 project through various means, including consistently involving users in our various advisory groups and roundtable meetings and adding senior staff members with investment analysis experience to proactively lead project-specific outreach efforts with a broad range of investors and other users. In addition, we have expanded user representation on the Board. We will strive to more consistently engage users in the early stages of a project.

Communication of conceptual basis

The PIR Report recommended that the FASB include in each standard a thorough discussion about the need for new financial reporting guidance and the benchmark characteristics of useful financial information considered. In addition, the PIR Report included a recommendation that if the FASB adopts one principle from a number of acceptable alternatives, the standard should explain how the principle selected best meets users' needs.

Determining the accounting principle that best meets users' information needs is ultimately a judgment based on conceptual, practical, and cost-benefit considerations. Those judgments are difficult because users' views about the most useful information often differ and the cost or difficulty of applying alternative accounting principles usually varies from entity to entity. In the case of FIN 48, the benefit to users was identified as more consistent (and thus more comparable) recognition, measurement, presentation, and disclosure of information about uncertain tax positions. The Board did not explicitly comment on how the qualitative characteristics were met in FIN 48; rather, it believed those qualitative characteristics were implicitly met by selecting recognition and measurement approaches based on the definitions of assets and liabilities articulated in Concepts Statement 6.

Although FIN 48 includes a discussion of the reasons for the Board's decisions and the conceptual basis for them, we agree that the Basis for Conclusions could have more clearly articulated the Board's consideration of the FASB's Conceptual Framework, in particular its consideration of the objectives and qualitative characteristics of financial reporting. We agree that a more robust description of conceptual and practical considerations should be contained within the Basis for Conclusions of future standards.

Communication of cost-benefit relationship

As noted in the PIR Report, the cost-benefit relationship assessment is difficult in standards setting. That is because the Board's assessment is subjective—it is based on judgments of expected benefits and costs associated with accounting requirements that have not yet been implemented. The FASB believes that the PIR process is an important feedback mechanism because it provides the opportunity to gather information about benefits and costs in the light of actual experience using the financial information and in applying the accounting requirements. In that regard, two PIR report findings are particularly relevant

(1) financial statement users believe that tax reserves are determined more consistently and are more comparable across entities (a primary objective of the standard) and (2) most preparers did not incur significant incremental implementation or continuing compliance costs.

The PIR Report recommended, though, that the FASB clearly describe its processes for evaluating the cost-benefit relationship of new accounting guidance. The cost-benefit relationship was an important consideration of the Board during the FIN 48 project. The Board obtained stakeholder feedback through comment letters, FASB advisory groups, and a roundtable meeting, and the Basis for Conclusions describes several changes made in response to concerns about the cost and complexity of certain proposed provisions. The Board agrees, however, that the brief explanation of the cost-benefit relationship in the Basis for Conclusions in FIN 48 does not fully describe the Board's evaluation of benefits and costs. We agree that going forward, all standards should include a thorough description of such evaluations. As noted previously, the Board is in the midst of a project to improve our communications in this area.

Communication of reexposure considerations

The PIR Report recommended that the FASB follow consistently its established policies and procedures related to reexposing all or part of a proposed standard. In particular, the findings state that it was not clear what thresholds the Board considered in deciding whether or not to reexpose FIN 48's disclosure requirements.

An Exposure Draft is an important way, but not the only way, to obtain external stakeholder feedback on an FASB proposal. With respect to the FIN 48 Exposure Draft, we considered the feedback received from comment letters and made some changes to the guidance, including adding certain disclosure requirements. The Board sought and obtained feedback on those additional disclosure requirements from users, preparers, and auditors through a public roundtable meeting and other communications. The Board decided that reexposure of the disclosure requirements in FIN 48 was not necessary based on the feedback received from this outreach. We acknowledge, however, that we did not clearly communicate our reexposure considerations in the Basis for Conclusions of FIN 48. The Board will strive to explain in all future standards how it assessed the need for reexposure, particularly when it decides that reexposure is not necessary.