Accounting Update - II

2008 Financial Management Seminars

Discussion Topics

- Allowance for Loan & Lease Losses (ALLL)
- Other-Than-Temporary Impairment (OTTI)
- Deferred Tax Assets - SFAS 109 & TB 56
- Goodwill and Other Intangibles (SFAS 142)
- Business Combinations - SFAS 141R
- Noncontrolling Interests in Consolidated Financial Statements – SFAS 160
- Accounting for Uncertainty in Income Taxes – FIN 48

Allowance for Loan & Lease Losses

*The 800 lb. gorilla is back! He now weighs **1000** lbs. and he's looking for more bananas!*

In the News – Just some of the Bananas he has eaten

- "Stocks Retreat Amid Bad Debt Worries"
- "Credit Woes Crunch Profits"
- Three largest US banks collectively increased their provisions in 3Q07 by $4.8 BIL, or 128% from 3Q06
- "Credit Scores Not-so-Magic Numbers"
- "Sinking Credit"
- … etc.

Allowance for Loan & Lease Losses

Antidotes for bananas!

GAAP Standards

- "Accounting for Contingencies" (**SFAS 5,** issued 1975)
- "Accounting by Creditors for Impairment of a Loan" (**SFAS 114**, issued 1993)

Regulatory Standard

- Interagency Policy Statement on ALLL & Q&A (**CEO 250**)
- Policy Statement on ALLL Methodologies and Documentation (**CEO 142**)

Allowance for Loan & Lease Losses

SFAS 5, para. 8 – an estimated loss contingency shall be accrued by a charge to income if **BOTH** of the following are met:

- information available prior to issuance of the financial statements indicated that it is **probable** that an asset had been impaired or a liability had been incurred at the date of the financial statements, and
- the amount of loss can be **reasonably estimated**

Allowance for Loan & Lease Losses

SFAS 5, para. 22: Grouping loans with similar risk characteristics

Consideration of whether an asset is impaired and the amount of loss can be reasonably estimated can be in relation to *individual receivables* (i.e. loans) **or** in relation to *groups of similar types of receivables* (loans). If the conditions are met, a loss accrual shall be made even though the particular receivables or loans that are uncollectible may not be identified.

Allowance for Loan & Lease Losses

SFAS 5, para. 23: Loss estimates based on historical data **and** environmental factors

The amount of loss to be provided for in the allowance will normally depend on, among other things, the ***experience of the enterprise***, information about the ability of individual debtors to pay, **and** appraisal of the receivables in light of ***current economic environment***.

Allowance for Loan & Lease Losses

Scope of **SFAS 114**

- Applies to All creditors
- Accounting by creditors for impairment of a loan by specifying how allowances for credit losses should be determined
- Also addresses accounting for loans restructured in TDR involving modification of terms of receivables
- Does **NOT** address when to record direct write-down
- Does **NOT** address how creditor should assess overall adequacy of allowance for credit losses

Allowance for Loan & Lease Losses

SFAS 114

- What is "**impaired**"? – A loan is impaired if it is probable that a creditor will not be able to collect all amounts due according to the contractual terms of the loan agreement.

- "**All amounts dues**"? – means both contractual interest payments and contractual principal payments will be collected as scheduled in the loan agreement

Allowance for Loan & Lease Losses

SFAS 114

- Measure impairment based on the PV of expected future cash flows discounted at the loans effective interest rate
- As a practical expedient may use
  - Loan's observable market price, or
  - FV of collateral less cost to sell **if the loan is collateral dependent** (must use this method for regulatory reporting, if loan is collateral dependent [FFIEC 2/10/95 Federal Register]
    - Loan is collateral dependent if repayment of loan is expected to be provided solely by underlying collateral (i.e. no other available and reliable sources of payment/foreclosure is probable)

Allowance for Loan & Lease Losses

The math is easy!

SFAS 5

+ SFAS 114

= “appropriate” ALLL *

Hey, did I see you “double count”?

There’s **NO DOUBLE COUNTING**, in ALLL!

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* **Cookies left in the jar to long can go stale.**

Allowance for Loan & Lease Losses

QUIZ #1: ***Always Marginal Capital FSB has a very large loan (>50% of capital) with residential developer Shack Model Homes, that appears impaired under SFAS 114. Shack's primary shareholder, Willie Slick, insists once again, that they need to sell just a few "Shacks" and that will allow then to make all 12 payments that are in arrears. While there are a few prospective buyers, none have committed to purchasing a Shack. Willie is out pedaling Shacks as we speak.***

1. How do we know that the loan to Shack is impaired?
2. Are FAS 114 reserves (i.e. individually impaired loans) "General" or "Specific"?
3. Where in FAS 114 does it distinguish between the two?
4. What is the difference between "general" and "specific"?
5. Does FAS 114 require "charge-off" when a loan is impaired?
6. How does categorizing a reserve as "general" vs "specific" impact TFR Schedules SC (SC283)?
7. How does the determination (GVA vs SVA) impact regulatory capital (Schedule CCR)?

Allowance for Loan & Lease Losses

QUIZ #2: **Fantasy Savings Bank (FSB) determines that Single Family Dwelling Igloo (SFDI) loans, which meet the definition of impaired under SFAS 114, are a homogenous pool that may be evaluated collectively for impairment. CEO Santa Claus, says; "FSB's internal policy places SFDI loans on non-accrual status at 90 days past due and applies rates of 10% and 20% to estimate ALLL on those loans with and without PMI, respectively". Rather than working with borrowers to restructure the loans, FSB generally proceeds with taking past due loans to foreclosure. Mr. Claus' CFO, Ester Bunny, tells us that recent sales of REO properties are showing much larger losses (50-70%) than the percentages being allocated and there have been denials of insurance claims.**

1. Do the responses in the questions to Quiz #1 (slide 11) differ in this quiz because these are single family residential loans and igloos at the North Pole?
2. Is the method of evaluating impairment in accordance with GAAP?
3. When are these loans impaired and, therefore subject to measurement?
4. Is it appropriate to consider insurance in the evaluation of ALLL?
5. What impact, if any, does global warming have on the fair value of the igloos?

Allowance for Loan & Lease Losses

Current Supervisory Guidance – 2006 Interagency Policy Statement (CEO 250)

- Reiterates key concepts of GAAP & Supervisory Guidance
- Areas of revision or update include:
  - Incorporates SFAS 114 (previous guidance predated 114)
  - Reinforces that ALLL is **institution-specific** amount
  - Deletes **standard percentages** for ALLL and updates analytics ("benchmarks") – No more benchmarks!!!!
  - Distinguishes between roles and responsibilities of BOD and management **and they are different**
  - Clarifies appropriate **treatment of off-balance sheet exposures**
  - Emphasizes support and documentation of ALLL (does NOT replace 2001 guidance – CEO 142)
  - Supplemented by 16 frequently asked questions

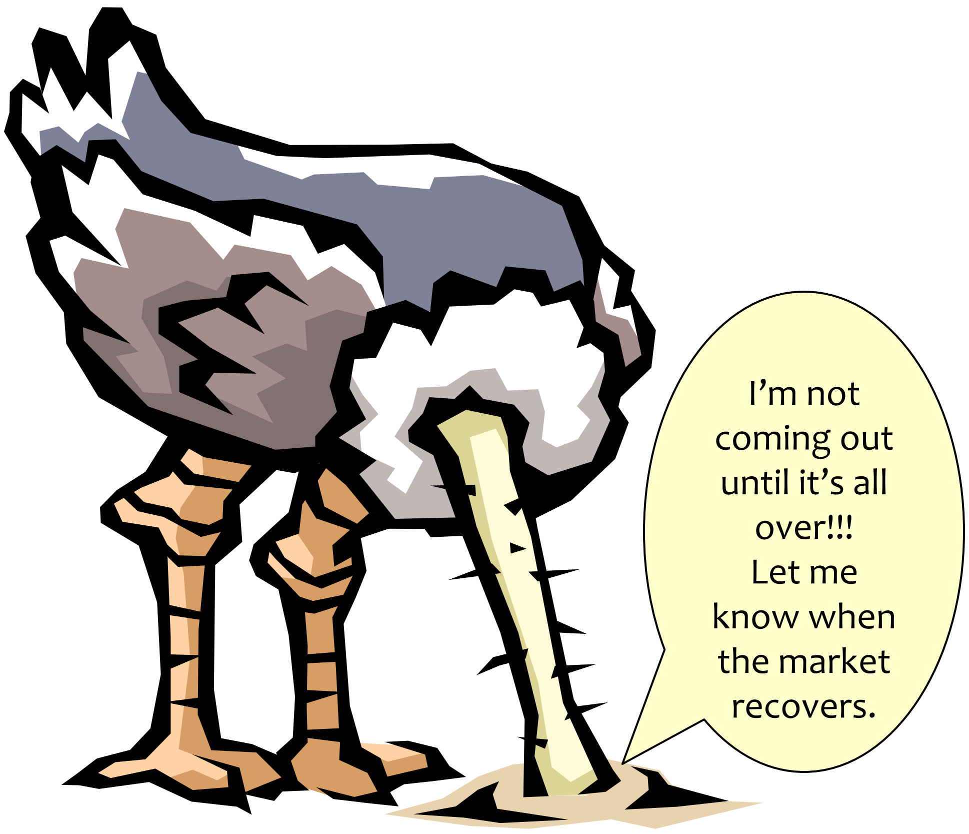
"Victory will never be found by taking the line of least resistance"

Winston Churchill

Other-Than-Temporary Impairment (aka OTTI) *…and the 3rd martini!*

Applicable guidance-

- SFAS 115
- FSP FAS 115-1 & FAS 124-1
- EITF 99-20
- SAB 59 & SAB Topic 5M
- SAS 1
- SAS 92
- CEO Letter 200



OTTI

Key Definitions

What is **Impaired**? Fair Value < Amortized Cost Basis

What is **OTTI**? Probable that investor will be unable to collect all amounts due according to the contractual terms

NOT intended to mean permanent!!!

OTTI

What do I need to do?-----------------> The 3 Step Approach

(It’s not a new Texas Dance!)

1. Is the investment impaired (fair value< cost)?
    - NO! No further action.
    - Yes! Proceed to Step 2.
2. Is the impairment other-than-temporary (see **slide 16**)?
    - No! No further action.
    - Yes! Proceed to Step 3.
3. Recognize an impairment loss equal to the difference between the investment’s carrying amount and its fair value.

OTTI

What's required if the security is OTTI?

Recognize an impairment loss equal to the difference between the investment's carrying amount and it's fair value

- Charge to income
- New carrying value (F/V)
- No recovery of recognized impairment

OTTI

Some indicators that decline in value might be OTTI

- Length of time and extent to which the market value has been less than cost
- Financial condition and near-term prospects of issuer
- Realization of a loss on subsequent disposition of the investment
- Whether the issuer has defaulted on scheduled interest and principal payments
- Downgrade in ratings by rating agencies
- Rising interest rates

OTTI

Forecasting Recovery!?

Nobody said that this is going to be easy!

Hey, somebody bring me another hat!
I'm looking for recovery and some liquidity!!

"As a practical matter there are limitations on the period of time that management can incorporate into its forecast of market price recoveries. As the forecasted market prices recovery period lengthens, the uncertainties inherent in management's estimate increase, which impact the reliability of that estimate. Market price recoveries that cannot reasonably be expected to occur within an acceptable forecast period should not be included in the assessment of recoverability." (Emphasis added)

(Excerpt from SEC "Current Accounting and Disclosure Issues in the Division of Corporate Finance", November 30, 2006 ---- http://www.sec.gov/divisions/corpfin/cfacctdisclosureissues.pdf)

General Debt Security Classification Guidelines – CEO #200

Type of Security	*Regulatory Classification*		
	Substandard	***Doubtful***	***Loss***
Investment quality debt securities with **"temporary"** impairment	---	---	---
Investment quality debt securities with **"other than temporary"** impairment	---	---	**Impairment**
Sub-investment quality debt securities with **"temporary"** impairment **– both HTM & AFS**	**Amortized Cost**	---	---
Sub-Investment quality debt securities with **"other than temporary"** impairment, including defaulted debt securities	**Fair Value**	---	**Impairment**

Note: Impairment is the amount by which amortized cost exceeds fair value.

SFAS No. 115
Debt Security Accounting

Category	Carrying Amount	Temporary Unrealized Gains/Losses	OTTI Unrealized Loss
Held-to-maturity	Amortized Cost	Ignored	*Security is written down to fair value (establishes a **new cost basis**).* ***Loss is recognized in** Statement of **Earnings.***
Available-for-sale	*Fair Value*	Accumulated Other Comprehensive Income (AOCI)	
Trading	*Fair Value*	*Statement of* Earnings	

OTTI & The 3rd Martini

A sad and unfortunately true saga about OTTI, and it may be at a thrift near you now!

Over lunch yesterday, at the Not-So-Optimist Club, CEO Capone told CEO Nitti that his CFO looked at some "accounting guidance" (slide 15) that very morning and, following a detailed and robust analysis, concluded a large security that they have appeared to be other-than-temporarily impaired. CEO Nitti (not real swift in matters of accounting) asked CEO Capone (even less swift in accounting), what the heck does that mean? After trying to explain OTTI, Capone told Nitti that he had to agree with his CFO and reluctantly approved the necessary adjusting entries. Capone said; "it wasn't a pleasant experience, it significantly reduced that BIG BONUS that the Board was going to give me, and, oh yeah, it also it reduced our capital too". Now, Nitti knew why Capone had that 3rd martini.

OTTI & The 3rd Martini

Our Sad but True Saga continues …

When CEO Nitti returned to his office, at Foreclosure FSB, he met with Elliot Ness, his CFO, to discuss this OTTI business. CFO Ness told Nitti that "ironically we have the exact same security here at Foreclosure FSB". Now, CEO Nitti wishes he'd had a 3rd martini, and wondered if his hopes for that BIG Bonus are also out the window.

1. How does this affect CEO Nitti's institution?
2. If Capone's security is OTTI, is Nitti's also?
3. How does it impact their already marginal capital?
4. Will the loss in value (recognition of OTTI) be recovered and when?
5. What are the liquidity needs of Foreclosure FSB?
6. Does Foreclosure have the ability & intent to hold until it recovers?
7. DOCUMENT via Robust Analysis!!

OTTI

Some Important Stuff for Capone & Nitti to consider in their evaluations

- Evidence-based judgment about recovery of FV
- Consider severity (how much) & duration (how long) of impairment in relation to forecasted recovery of FV
- As severity/duration increases, greater evidence about forecasted recovery of FV is required to conclude impairment is "temporary" (i.e. not OTTI)
- The further expected recovery in FV is from initial impairment, the greater the evidence required
- Ability to hold security indefinitely would NOT, by itself, allow investor to avoid OTTI
- Evaluate with a clear and objective mind considering all evidence (both positive and negative) and indicators
- Hold off on those 3rd martinis until after the evaluation

It took an accountant

to catch Al Capone

OTTI

How can Capone & Nitti avoid getting splattered when the **$#^* hits the fan**?

HINT!!!!!!!!!!

Intent *and* **Ability** to Hold a key factor!

But, is it enough?

DOCUMENT, DOCUMENT, DOCUMENT Testing and Conclusions!

OTTI, Documentation & the Institution

- **SEC Staff Guidance (Topic 5M)** – *"Unless evidence exists to support a realizable value equal to or greater than the carrying value of the investment, a write-down of fair value accounted for as a realized loss should be recorded".*

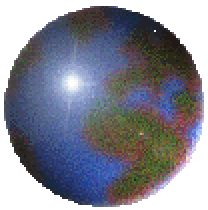
  *(EDITORIAL NOTE: In essence, this is a **rebuttable presumption** that there is OTTI when sufficient written documentation does not exist.)*

- *Where significant and prolonged declines in value persist, there is a rebuttable presumption of OTTI.*
- *Burden of proof to support assertion of temporary impairment is on institution*
- *From a S&S standpoint, failure to provide requisite documentation likely will result in presumption of OTTI*

OTTI, Documentation & the Examiner

- Examiners should encourage institutions to highlight OTTI as a significant accounting policy with their external auditors and have their auditors review OTTI practices and procedures and material temporary and other-than-temporary impairment assertions and conclusions.

- **CEO Letter 5, (9/92)** – provides examiners with guidance on the use of external audits to supplement exam procedures. Examiners may consider work paper review to determine the audit procedures performed and conclusions reached regarding the institution's OTTI practices and procedures, the existence of material impairment conclusions, disagreements with management and waived external auditor accounting adjustments.



Take a moment and think about it.

"Enlightened statesmen may not always be at the helm"

James Madison

You are an OTS regulator, maybe an institution Board member, CEO or CFO, or an independent auditor, and you recently attended a seminar where OTTI was discussed at length. You discussed all aspects of OTTI, including documentation, a robust analysis of all available evidence, including liquidity needs, business plans and forecasts and what the meaning of ability and intent to hold to forecasted recovery means. You return to your office and you glance at your financial statements and see the following paragraph at the end of the Independent Auditors' Report. Or you are the concurring review partner and you begin your review of ABC Bank's financial statements.

"As discussed in Note 2 to the consolidated financial statements, the Company holds two mutual funds in its securities available for sale portfolio which have been in unrealized loss positions for over 48 months. The **ultimate recovery of the value of these funds cannot presently be determined**. Management has stated that **they have the intent and ability to hold these funds until anticipated recovery**. Accordingly, no impairment charge has been recorded on the consolidated statement of income."

Deferred Tax Assets – SFAS 109 & TB 56

- **SFAS 109** – "Accounting for Income Taxes"
  - Taxable temporary differences
  - Deductible temporary differences
  - Valuation allowances

- Regulatory Reporting
  - GAAP (SC, SO, etc.)
  - **TB 56** limitation for regulatory capital (CCR)

Operating Losses!
Repossessions!
Increases in ALLL!
Securities downgrades!
OTTI!
What's next? Oh no, not TAX issues!

*Deferred Tax Assets – **SFAS 109** & TB 56*

- "**Taxable** temporary differences" – differences that result in taxable amounts in future years when related asset or liability is recovered or settled (DTL)

- "**Deductible** temporary differences" – result from amounts that will be deducted in future years (DTA)

*Deferred Tax Assets – **SFAS 109** & TB 56*

- Deferred taxes determined separately for each individual tax-paying entity
- DTA & DTL measured independent of one another
- Valuation allowance –
  - Evaluate gross DTA
  - All evidence (+ and -)
  - Realization "more likely than not" (>50%)

Deferred Tax Assets – SFAS 109 & TB 56

- Its really not that difficult, or shouldn't be.

$ DTA

(VA)

(DTL)

$ NDTA

*Deferred Tax Assets – SFAS 109 & **TB 56***

- DTA that can be realized from the following are **not** subject to limitation
  1. Taxes paid in prior carryback years
  2. Future reversal of existing taxable temporary differences

- DTA **subject to limitation,** when realization depends on future taxable income (excluding 1 and 2 above) or tax planning strategies, limited to lesser of:
  1. Amount realizable in one year (quarterly analysis) or
  2. Ten percent (10%) of core capital (CCR)

Goodwill and Other Intangibles - SFAS 142

- With declines in the value of reporting units there may be greater risk of impairment in goodwill.

- Some primary drivers of declines
  - Increased loan losses
  - Increases in foreclosures
  - Illiquid markets for securities

Goodwill and Other Intangibles - SFAS 142

- Test for impairment at the reporting unit.
  - **Step 1** - Identify potential impairment by comparing fair value of a reporting unit with the carrying amount including goodwill
  - **Step 2** - measure the amount of impairment loss by comparing the implied fair value of reporting unit goodwill with the carrying amount of that goodwill

Goodwill and Other Intangibles - SFAS 142

- Loss cannot exceed the carrying amount of goodwill
- Test **at least** annually (or sooner if circumstances exist) usually at the same time of year
- After impairment loss is recognized the adjusted carrying amount of goodwill will be its new accounting basis
- Subsequent reversal of impairment loss is prohibited
- Intangibles subject to amortization are tested in accordance with SFAS 144.

Goodwill and Other Intangibles - SFAS 142

Don’t wait to test impairment!

But, my regular annual impairment test isn’t scheduled until November! We’ll record the write off then.

- From SFAS #142, paragraph 28: "Goodwill of a reporting unit shall be <u>tested between annual tests</u> if an event occurs or circumstances that would more likely than not reduce the fair value of the reporting unit below its carrying amount.”

SFAS No. 141R "Business Combinations"

- Why issued?
- Scope?
- Improvement of current accounting?
- Recognition of identifiable assets acquired and liabilities assumed
- Non controlling interest
- Contingent assets and liabilities
- Goodwill and gain from bargain purchase

SFAS No. 141R

- Why issued?
  - Improve relevance, representational faithfulness, and comparability of business combinations
    - Recognize and measure identifiable assets, liabilities assumed and noncontrolling interest
    - Recognize and measure goodwill acquired or gain on bargain purchase
    - Enhance disclosures in F/S

SFAS No. 141R

- The Scope
  - All business entities, including mutuals
  - Not within scope:
    - Formation of a JV
    - Assets or groups that is not a business
    - Entities/businesses under common control
    - Not-for-profit organizations

SFAS No. 141R

- Improves current accounting practices
  - Replaces SFAS 141
  - Defines “acquirer” as the entity that obtains control
  - Retains it’s fundamental requirements
    - Acquisition Method
    - Identification of acquirer
    - Identifying and recognizing intangible assets separate from goodwill

SFAS No. 141R

- Recognition & measuring identifiable assets acquired and liabilities assumed
  - Fair value at acquisition date
  - Limited exceptions
  - Unlike 141, <u>NOT</u> a "<u>cost allocation</u>" process
  - Acquisition-related costs under 141 were part of acquisition and allocated to acquired assets and liabilities
  - Under 141R they are separately recognized

SFAS No. 141R

- Recognition & measurement – cont'd
  - Restructuring costs
    - 141 – costs expected but not obligated recognized as liability assumed at acquisition date
    - 141R – recognized separately from business combination

SFAS No. 141R

- Recognition & measurement – cont'd
  - "Step Acquisition" (achieved in stages)
    - 141R – recognize identifiable assets and liabilities, and noncontrolling interest in acquiree, at the full amounts of their F/V
    - 141 – cost of "each investment" allocated individually at each step of acquisition

SFAS No. 141R

- Noncontrolling Interests (aka minority interest)
  - 141 - did not provide measurement guidance (blend of historical and fair values assigned)
  - 141R – measured at F/V & will result in recognition of goodwill attributed to noncontrolling interest
  - SFAS 160 (issued 12/07)

SFAS No. 141R

- Contingent Assets/Liabilities
  - 141 – permitted deferred recognition of preacquisition contingencies until FAS 5 recognition criteria met
  - “Contractual” contingencies – recognize A/Ls at acquisition-date at F/V
  - “Noncontractual” contingencies measured at acquisition-date F/V if it is ***more likely than not*** that they meet asset/liability definitions of Concepts No. 6 (criteria not met at acquisition date – use other applicable GAAP, including FAS 5)
  - Continue to report A/L from contingent recognition at F/V absent new information about possible outcome of contingency

SFAS No. 141R

- GOODWILL
  - Required recognition as of acquisition date
  - Residual – excess of consideration transferred + F/V of any noncontrolling interest in acquiree at acquisition date over F/V of identifiable net assets acquired
  - Contingent consideration required to be recognized at F/V and will be included in goodwill (usually NOT recognized at acquisition date under 141)

SFAS No. 141R

- Bargain Purchase
  - Defined – total acquisition-date F/V of identifiable net assets acquired exceeds the F/V of consideration transferred + any noncontrolling interest
  - Acquirer recognizes the excess in earnings as a GAIN
  - 141 – "Negative goodwill" allocated pro rata as reduction of particular assets acquired

SFAS No. 141R

- Other Changes & Amendments
  - FAS 109 – recognize changes in deferred tax benefits from business combination in income from continuing operations in period of combination or directly to contributed capital, depending on circumstances (e.g. changes in valuation allowances on previously existing DTA)
  - FAS 142 – guidance on impairment testing
  - Elimination of many EITFs and other business combination guidance

SFAS No. 141R

- Effective date –
  - Applies "prospectively" to combinations with acquisition date on or after the beginning of the first annual reporting period beginning on or after 12/15/08
  - No application before that date
  - Effective date same as SFAS 160

SFAS No. 160 – "Noncontrolling Interests in Consolidated Financial Statements"

SFAS No. 160 – In a Nutshell!

- What is it?
- Objective?
- Scope?
- Improve current accounting practice?
- What will my F/S look like?
- Effective when?

SFAS No. 160 – Noncontrolling Interests

- What is a “Noncontrolling Interest”?
  - aka “minority interest”
  - Portion of subsidiary equity not attributable, directly or indirectly, to parent.

SFAS No. 160 – Noncontrolling Interests

- Objective (improve relevance, comparability and transparency in consolidated F/S)
- Requires:
  - Clearly identified, labeled and presented in B/S, separate from parent's equity
  - I/S separation of amounts attributed to parent and noncontrolling interests
  - Similar and consistent accounting for and disclosure of changes in ownership interests/equity transactions
  - Consistent guidance for "deconsolidation", retention of noncontrolling interest and gains/losses from deconsolidation (F/V)
  - Sufficient disclosures that identify and distinguish between the interests of parent vs. noncontrolling owners

SFAS No. 160 – Noncontrolling Interests

- Scope – applies to the consolidated F/S of all entities that have noncontrolling interests in one or more subsidiaries or that deconsolidate a subsidiary
- Except – not-for-profit entities

SFAS No. 160 – Noncontrolling Interests

- How does it improve current practice?
  - Amends ARB 51
  - Clarifies that noncontrolling interest is an ownership interest
  - Some reported minority interest as liabilities, some reported in "mezzanine" (between liabilities and equity) – NOT ANY MORE!
  - Consolidated income includes amount of net income attributed to <u>both</u> parent and noncontrolling interests

SFAS No. 160 – Noncontrolling Interests

- What's my equity in B/S going to look like?

Liabilities:		
Total liabilities	$ 555,000	$ 459,000
Equity:		
ABC Co. shareholders' equity:		
Common stock, $1 par	200,000	200,000
Paid-in capital	42,000	50,000
Retained earnings	194,500	167,000
Accumulated other comprehensive income	22,500	16,000
Total ABC Co. shareholders' equity	459,000	433,000
Noncontrolling interest	26,000	48,000
Total equity	485,000	481,000
Total liabilities and equity	$ 1,040,000	$ 940,000

SFAS No. 160 – Noncontrolling Interests

- What's my I/S going to look like?

ABC Co.
Consolidated Statement of Income
Year Ended December 31

	20X3	20X2
Revenues	$ 395,000	$ 360,000
Expenses	(330,000)	(305,000)
Income from continuing operations, before tax	65,000	55,000
Income tax expense	(26,000)	(22,000)
Income from continuing operations, net of tax	39,000	33,000
Discontinued operations, net of tax	—	(7,000)
Net income	39,000	26,000
Less: Net income attributable to the noncontrolling interest	(1,500)	(4,000)
Net income **attributable to ABC Co.**	$ 37,500	$ 22,000

SFAS No. 160 – Noncontrolling Interests

- Changes in parent's ownership
  - Parent retains controlling interest-
    - Sales & purchases of ownership interest are "equity transactions"
    - No gain/loss recognized
    - Carrying amount of noncontrolling interest adjusted (difference between FV of consideration paid/received and carrying amount is equity attributed to parent)
    - Additional paid-in capital

SFAS No. 160 – Noncontrolling Interests

- Changes in parent's ownership
  - **Parent ceases** to have **controlling** interest-
    - Deconsolidation of subsidiary at date parent ceases to have control
    - Gain/loss recognized in income
    - Any retained noncontrolling interest measured at fair value

SFAS No. 160 – Noncontrolling Interests

- Expanded disclosures required
- Amends various pronouncements
- Does NOT change requirements in FASB Interpretation No. 46 (Consolidation of VIEs)
- Effective date corresponds with SFAS 141R

FASB Interpretation No. 48 (aka FIN 48)

Accounting for Uncertainty in Income Taxes

- First effective for fiscal years beginning after 12/15/06 (2007 calendar year entities)
- Calendar year entities were required to adopt as of beginning of 1st quarter 2007 *#
- Any changes to existing income tax reserves or new reserves recoded at adoption are recorded as cumulative effect adjustment to retained earnings

*** Includes reporting in TFRs and Call Reports**

 # FSP FIN 48-2 (2/1/08) – deferral (certain non-public entities)

FIN 48

Accounting for Uncertainty in Income Taxes

Oops! We're not public, have a calendar year end and we forgot to adopt FIN 48 in our March 2007 TFR. What the heck do we do now?

I guess with the issuance of FSP FIN 48-2 our sin is forgiven?

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Whoa there Kemosabi, what about me? I'm not a public institution and I adopted FIN 48, like I thought I was suppose to, in my 3/07 TFR.

FIN 48
Accounting for Uncertainty in Income Taxes

What does FIN 48 do?

Provides guidance on:

- Derecognition
- Classification
- Interest & Penalties
- Accounting in Interim Periods
- Disclosure

FIN 48
Accounting for Uncertainty in Income Taxes

- Provides rules for recognition of income tax benefits, the ultimate sustainability of which are/may be uncertain due to potential challenges by taxing authorities

- Applies only to income taxes (i.e. net worth-based franchise taxes, sales taxes, property taxes, etc. not impacted by FIN 48)

- Provides a two-step process for recognition of any tax benefit resulting from a tax position claimed (or to be claimed) on an income tax return

FIN 48
Accounting for Uncertainty in Income Taxes

<u>Step 1 – recognition</u>

- Examines sustainability of position based solely on technical merits
- "More likely than not" (>50%) that position will be sustained
- In making determination, it must be presumed that the position will be examined by taxing authority that has knowledge of all relevant information

FIN 48
Accounting for Uncertainty in Income Taxes

Step 2 – Measurement

- Practical measurement portion likely to be sustained upon settlement with taxing authority

- Consider all possible outcomes of negotiations

- Greatest amount of benefit that is “more likely than not” to be sustained is recorded

FIN 48 - Example

<u>Step 2 – Measurement</u>

- Amount of benefit recognized is measured at maximum amount which is more likely than not to be realized
- Not single best estimate
- Not probability weighted at $58.00

Tax position to be sustained	Percent of likelihood	Cumulative Percentage
$100	15%	15%
$80	20%	35%
$60	20%	55%
$40	30%	85%
$20	15%	100%

FIN 48
Accounting for Uncertainty in Income Taxes

- A tax position considered settled through examination when:
  - Tax authority has completed exam, including any admin procedures
  - Taxpayer does not intend to appeal/litigate any aspect of completed exam
  - Highly unlikely that taxing authority would subsequently re-examine the position in the completed exam

FIN 48
Accounting for Uncertainty in Income Taxes

- Interest and penalties must be considered in calculation & can be part of tax expense
- OR interest exposure can be recorded as interest expense and penalties as other expense
- Liability for unrecognized benefits (or reduction of refunds) NOT combined with deferred tax liabilities or assets
- Various disclosures (see para. 20 – 21)

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Accounting for Uncertainty in Income Taxes

If more likely than not threshold is NOT met in period for which tax position was taken, recognition should be in 1st interim period that meets any one of the following:

- More likely than not threshold is met by reporting date
- Tax matter is ultimately settled through negotiation/litigation
- Statute of limitations tax authority to examine and challenge has expired

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Accounting for Uncertainty in Income Taxes

- Derecognize a previously recognized tax position in the first period that it more likely than not that the position will NOT be sustained upon examination

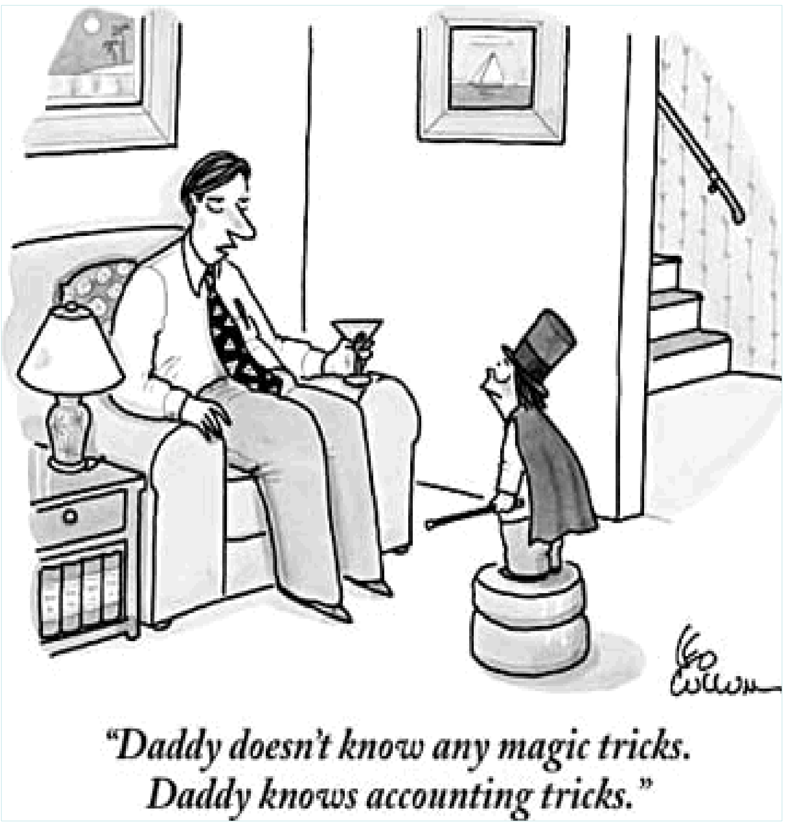
- Valuation allowance is NOT a permitted substitute for derecognition

- Subsequent changes in judgment result in evaluation of new information not a new evaluation or interpretation

"In critical and baffling situations, it is always best to return to first principle and simple action."

Winston Churchill

To discuss "Accounting Tricks" contact us.



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