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General Overview

This paper identifies the form and content necessary for disclosures relating to a financial interpretation (FIN) which deals with uncertainty of income taxes. The Financial Accounting Standard Board (FASB) issues such financial interpretations to further clarify published accounting standards in the event that questions arise regarding application and scope of the accounting standard.

During the time frame during which the research contained within these pages was gathered, FASB implemented a codification system that has changed the way this interpretation is referenced. For applicability of research, the interpretation will be addressed here under the prior method of numbering. However, it should be noted that the information can be referenced going forward under Accounting Standards Codification subtopic 740-10, Income Taxes (FASB ASC 740-10). FASB ASC 740-10 is addressed in this paper as FIN number 48, *Accounting for Uncertainty in Income Taxes*.

The application of FIN 48 is assessed by looking into two public companies headquartered in the greater Grand Rapids area of West Michigan. The companies have been chosen to compare and contrast disclosures across industries, to identify specific tax positions taken within each company, and to note or identify compliance and non-compliance to the interpretation disclosure requirements within a given set of company financials. To close this research, the influence that FIN 48 has had and continues to have on the Grand Rapids community shall be discussed herein.

FIN 48 is the interpretation of Financial Accounting Standard (FAS) 109, *Accounting for Income Taxes*. This particular accounting standard requires recognition of "the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an enterprise's financial statements or tax returns" (FASB Summary). FIN 48 attempts to explain FAS 109, providing guidance on the use of the accounting standard from company to company.

FIN 48 came about as one of many FASB solutions in an attempt to increase transparency in financial statements. The focus on transparency of a corporation's tax structure has increased following publicity that stated "a large number of material weaknesses and significant deficiencies initially reported in Sarbanes-Oxley were traceable to the construct of the entity's income tax expense" (Benassi, 2008).

Initially, FASB responded to the deficiencies by requiring the completion of Schedule M-3 in financial statements. Schedule M-3 identifies book to tax differences in both the permanent and temporary categories for mid-to-large sized companies or, as a general rule, companies exceeding $10 million in assets. This documentation came into practice in 2006 in an attempt to identify tax positions taken by larger companies. FIN 48 followed shortly thereafter as yet another attempt to improve financial statements. Though this time, small-sized companies were not exempt from compliance.

FASB issued FIN 48 to apply to years beginning after December 15, 2006. Public companies complied immediately but not all businesses were expected to comply the 15th of December in the year 2006. For non-public and not-for-profit companies, FASB extended the compliance deadline.

The board offered the extension to give companies the time to understand the necessary documentation required. The extension was also intended to allow these companies the time to gather the resources necessary to implement FIN 48. Additionally, FASB hoped the delay would quell rising fears and frustrations. At that time, trepidation had spread among private companies in response to the surrounding confusion and complexity required by the interpretation.

FASB initially gave non-public and non-profit companies one year, until December of 2007, to comply. This date was later extended to "fiscal years beginning after Dec. 15, 2008 (that is, until 2009 for calendar-year companies)" (Stromsen, 2009) due to the continued confusion related to its application. Concerned that the leniency shown to non-public companies would be interpreted as an inability to hold these companies to FASB's standards, the board ceased extending after the December 15, 2008 mark.

Adopting FIN 48

Public and non-public company financial statements for 2009 therefore required FIN 48 documentation; these statements have been issued in 2010. As such, the beginning of the current year prompted several conversations and workshops within the public accounting spectrum containing the buzzwords "FIN 48," "tax positioning," "nexus," and "road map." Public accounting firms dealing with small to mid-sized private companies focused heavily on catching staff up on the latest issued documentation.

These public accounting firms deemed the FIN 48 discussions necessary because private company-focused accountants had begun aiding companies in preparation of the first set of financial statements containing FIN 48 disclosures. In addition to helping companies with financials and FIN 48 disclosures, public auditors were now issuing opinions on those statements.

It should be noted that private companies could have chosen to adopt the interpretation earlier but many had not at the time done so for various reasons. Therefore, companies that procrastinated until the last minute to adopt FIN 48 could be found scrambling to identify and document tax positions taken at state, national, and international levels reaching back over a number of years. In order to do so, many firms turned to external auditors or third party advisors for clarification.

The strategy of employing outside assistance could be costly but has been often necessary for small companies lacking the tax know-how to properly comply with FIN 48. It has not been mandated that these companies seek an outside opinion, but many companies have done so in order to assure them that they are in compliance with the law (Benassi, 2008); these companies stood to gain greatly from the knowledge that outside experts offered.

FIN 48 Defined

In its simplest explanation, FIN 48 measures deferred tax assets and liabilities by utilizing a two-step approach. The first step deals with measurement, the second with reporting. To begin, companies must identify the tax positions taken both in the current year and those taken in previous years. These positions are then evaluated using a "more likely than not" (MLTN) criterion.

The MLTN criterion mandates that companies identify "whether a tax position will be sustained on examination by the taxing authority—assuming the authority has full knowledge of all relevant information" (Deputy, 2009). "If a tax position does not meet this more-likely-than-not threshold, none of the tax benefits from the position that are reported on the income tax return can be reported in the financial statements" (Wells, 2007).

The second step of FIN 48 becomes applicable once tax positions qualify MLTN of being upheld upon review of the taxing authority. If the tax positions taken are more likely than not to be sustained, then a company is able to "recognize the largest amount of benefit having a greater than 50 percent likelihood of ultimately succeeding" (Pitt, 2009). This percentage is measured by a "unit of account" basis rather than a position-by-position basis (Deputy, 2009). As implied earlier in this paper, the units of account are measured at local, state, and foreign levels.

These units of account may appear to be simplistic to measure to an inexperienced eye, but local, state, and foreign units are often not even easy to identify in practice, let alone measure. There are many things a company or outside compliance expert must consider before establishing whether or not a level exists.

For example, companies must first distinguish whether or not a tax return is necessary to file in a specific state by assessing the rules of nexus for each state in question. Whatever the decision reached, it does not exempt a company from compliance rules. The conclusion of whether or not to file a tax return is, in itself, a tax position necessary to report under FIN 48.

In addition, some companies have multiple units within the multiple levels of measurement. For instance, General Motors (GM) falls under this multi-faceted tax positioning. The company, in 2009, was recorded as filing "over 6,500 tax returns in over

250 global tax jurisdictions" (Blitz, 2009). That creates a large potential for tax positions to be examined under FIN 48.

Controversy Captured

Essentially, the large scope that FIN 48 covers has led to early comparisons between the financial interpretation and Sarbanes-Oxley (SOX). While this comparison might be drastic, a significant amount of money and time has been put forth by companies in order to comply with the new interpretation as was seen with SOX compliance. The costs are not one-time occurrences either.

Companies could not simply restate their FIN 48 disclosures each year. Rather the disclosures, as well as any new positions taken, must be evaluated and reassessed at the end of each reporting period. These disclosures have taken considerable time, money, and effort in the initial year of compliance, but the cost does not dissipate in years following. Sizeable annual costs exist in determining the proper FIN 48 disclosures as well because all tax positions must be reevaluated.

These continual costs have not been the only characteristic of FIN 48 that have had companies up in arms however. Many businesses feared identifying uncertain tax positions taken in their operations because they felt it made the likelihood of audit from the Internal Revenue Service (IRS) too great. The identified tax positions, accompanied by the percentage of likelihood that those tax positions would stand up to the scrutiny of the IRS's preying eyes, had companies apprehensive that they were drafting out a potential road map for the IRS, highlighting problems and calling attention to any potential red flags.

In response, the IRS attempted to eliminate fears by publishing announcements and articles stating that the FIN 48 disclosures are not specific enough to lay out a clear road map. The disclosures may have shown the existence of uncertain positions but they did not direct the eye of the auditor. Additionally, little to no increase in IRS activity has been reported in this area as a result of FIN 48 disclosures in companies' financial statements.

Even so, public accounting firms responsible for documenting and identifying uncertain tax positions were just as concerned about the necessary requirements for companies filing financials in compliance with FIN 48 requirements as the companies were themselves. The accounting firms were navigating through the dos and do-not's of FIN 48 at the same time as the companies; however, they were expected to be leaders in the area.

This responsibility had some public accounting firms are asking questions such as "How do we facilitate obtaining uncertain tax positions from other accounting firms when the client utilizes separate firms for tax and audit work?" or "Do we come into any independence issues when providing both audit and tax positions for the same client?" Another popular question that arose was as follows: "How do we comply with FIN 48 without tipping our hand too far to the IRS?"

As mentioned above, the IRS has denied having the ability to drill down directly into uncertain tax positions based off the evaluation of FIN 48 disclosures, but the other questions being asked deserved answers too. The American Institute of Certified Public Accountants (AICPA) has attempted to provide those answers. According to AICPA material, "external auditors can provide tax opinions without compromising independence" (Benassi, 2008). External auditors can also inform clients of the reasons the company did or did not meet the MLTN threshold (Benassi, 2008).

Evaluation of 10-Ks Related to FIN 48

Now that the basic make-up and concern surrounding FIN 48 has been discussed herein, it is best to evaluate FIN 48 within the confines of specific companies' financial statements. By looking at two companies, a general view of FIN 48's application can be gauged. For this purpose, the well-known, respected companies of Steelcase and Wolverine World Wide have been chosen. Both companies began in West Michigan and grew to be successful, global companies from their more beginnings. Though they are similar with success, their industries differ greatly.

Steelcase

Steelcase, headquartered in Grand Rapids, MI, is the leading manufacturer of office furniture recognized on a global level (Steelcase, 2010, p. 1). The company began in 1912 and now offers company solutions to business, healthcare, and education needs by creating balanced environments within which people work (2010, p. 1). The company, privately owned for 86 years, went public in 1998 and, for the year ended February 26, 2010, employed 11,000 workers internationally while generating $1.3 billion in annual revenue (2010, p. 2).

As required by FASB, Steelcase dedicates a portion of the annual 10-K to the topic of income taxes. Within this section of the 2009 financial statements, the company stated that all of the tax positions are evaluated quarterly or with greater frequency as new information becomes available. Any adjustments to these positions have been made as needed for all state, local, and non-U.S. regarding uncertain tax positions (Steelcase, 2010, p. 33).

In addition, Steelcase has undergone a preliminary audit with the IRS under the Compliance Assurance Process (CAP) to help identify and resolve any issues before filing a tax return (Steelcase, 2010, p. 80). CAP has shown itself to be useful for companies that are centered on a more risk-averse culture because it allows for calculated tax maneuvers without as much fear of negative IRS findings.

For the 2009 fiscal year, Steelcase stated that its "liability for uncertain tax positions in these [state, local, and non-U.S.] jurisdictions was $0.2" (2010, p. 33) and that the company expected minimal future liabilities relating to uncertain income taxes; the company chose to list its financial data in millions of dollars. Steelcase also identified a potential tax benefit from operating loss carryforwards before valuation allowances at an estimated $89.6. However, the company showed a valuation allowance of $34.6 under the MLTN criteria and therefore reduced the realized tax benefit to $55.0 (2010, p. 33).

In addition to the benefit from operating loss carryforwards, Steelcase also "realized a tax benefit from credit carryfowards of $24.8" (2010, p. 34). These credit carryforwards, in combination with the operating loss carryforward, lead MLTN to a combined benefit of $79.8 to be realized in future periods (2010, p. 34). However, there is no definite measurement to determine when or whether a tax position qualifies MLTN so the company explained how these numbers were determined in the 10-K by utilizing a general explanation.

Steelcase determined these numbers "based on the expectation that related operations will be sufficiently profitable" (2010, p. 34) or that "various tax, business and other planning strategies will" allow the company to "utilize the carryforwards" (2010, p.

34). A valuation allowance is established in the event that realization of a deferred tax asset becomes doubtful.

In addition to establishing an allowance, Steelcase stated how a misjudgment in expected tax benefits would affect the company. For 2009, a "10% decrease in the expected amount of tax benefit to be realized on the carryforwards would have resulted in a decrease in net income for 2010 of approximately $8" (2010, p. 34). Furthermore, "changes in tax laws and rates could also affect recorded deferred tax assets and liabilities in the future" (2010, p. 34).

Although Steelcase did not clearly identify any tax positions taken, the company noted possible benefits and allowances and has given investors an estimation of the financial effect a misjudgment would cause for these recognized benefits. Assuming these disclosures have been made truthfully, it appears that Steelcase has followed proper disclosure of FIN 48.

Wolverine World Wide

A far cry from furniture, Wolverine World Wide "is a leading designer, manufacturer and marketer of a broad range of quality casual, rugged outdoor and work footwear" (Wolverine, 2010, p. 5). Over the past few years, the company has focused efforts to extend some of the footwear brands; as a result, Wolverine World Wide now offers "casual, outdoor and work apparel" as well (2010, p. 5).

Though headquartered just outside of Grand Rapids, MI in the city of Rockford, Wolverine World Wide's reach is global. In the 2009 fiscal year, "approximately 42.9 million pairs/units of the Company's branded footwear and apparel were sold […] in approximately 180 countries and territories around the world" (2010, p. 4). This large reach of recognized revenues has also introduced the company to several taxing jurisdictions within both US and foreign territories.

As expected, Wolverine World Wide's financials also included mandatory FIN 48 disclosures. However, Wolverine World Wide provides a little more insight into the potential impact of FIN 48 in that the 2008 Wolverine World Wide 10-K directly mentions FIN 48. It also notes the effect the application of FIN 48 had on company financials, listing its charts in thousands of dollars. The appendix detailing income taxes began with a summary of changes made at the start of implementation.

The company adopted provisions of FIN 48 "on the first day of fiscal year 2007, December 31, 2006" (Wolverine, 2009, p. A-17). At that time, Wolverine World Wide recognized an increase in liability for unrecognized tax benefits of $369,000 with "a corresponding decrease to the December 31, 2006 balance of retained earnings" (2009, p. A-17). This change was made in response to previously unrecognized tax benefits totaling $1,599,000, net of tax (2009, p. A-17).

For the year ended January 2, 2010, Wolverine World Wide recorded $8,396 in unrecognized tax benefits, an increase of $5,225 related to current year tax positions (2010, p. A-17). Additionally following management review, the company disclosed that an amount of foreign net operating loss carryforwards did not fall under the MLTN to be realized criteria (2010, p. A-17). As a result, the valuation allowance for deferred tax assets was increased by $380 to total $1,026 at year end (2010, p. A-17).

Wolverine World Wide stated that the company was "undergoing several routine periodic audits in both domestic and foreign tax jurisdictions" at that time. As a results of these audits, Wolverine World Wide disclosed, the "amounts of unrecognized tax benefits could change in the next 12 months […]; however, any payment of tax is not expected to be significant to the consolidated financial statements” (2010, p. A-17).

Unlike Steelcase, Wolverine World Wide did not put a monetary amount on potential misstatements of unrecognized tax benefits but rather stated that the effect would immaterial. Though the statements differ in depth of information, both companies would be found in compliance with disclosure requirements. Additionally, Steelcase mentioned an allowance while Wolverine World Wide prefaced disclosure of the allowance by outright stating that the position taken did meet the MLTN criteria and both responses suffice.

Having read through both financial statements, it is clear that a simple overview of the data disclosed would not be enough to identify any tax positions that might not withstand the rigidity of the IRS. A general category of tax positions is mentioned but, considering the scope of both operations, that information would not lead an auditor directly to any one position. Wolverine World Wide, for instance, mentions that a foreign tax position did not meet the MLTN criteria but does not divulge which foreign sector was affected. A full audit would need to be completed to gain any pertinent information with regards to the uncertainty of income taxes and MLTN probability that those tax positions would withstand IRS scrutiny.

FIN 48 and the Local Community

By examining two of the most high-profile companies within the greater Grand Rapids, this paper attempts to gauge an idea of the impact FIN 48 might have had on non-public companies. It can be assumed that many smaller companies would not have detailed disclosures such as the Steelcase and Wolverine World because they would lack the resources or reasoning to take tax potions that might negatively impacted earnings if overturned.

The city of Grand Rapids, home to the Steelcase headquarters, is located approximately one half hour from Lake Michigan on the western coast of the state of Michigan. With events such as ArtPrize, a free, annual art contest that brings in contestants from around the world, Grand Rapids is quickly becoming a recognized destination on the map.

In fact, "it is Michigan's second largest city with a metropolitan population of 1,302,372," (Wiltzer, 2010) second to Detroit. Residents and visitors of Grand Rapids enjoy the up-and-coming status of the area, the city's focus on the arts, its LEED initiatives, and Grand Rapids' big city appeal combined with its close community feel.

Greater Grand Rapids is more than a welcoming destination, however. It is also a business hub for several recognized and respected company names. The Grand Rapids area hosts headquarters for companies such as "Herman Miller, Haworth, Alticor (formerly Amway)…, and Meijer stores" (2010). The list also includes Steelcase and Wolverine World Wide, the two companies whose financial statements were examined above. Of these big names, Herman Miller, Steelcase and Wolverine World Wide are public companies. Haworth, Alticor, and Meijer are private.

The blend of respected companies in both the public and private industries indicates that Grand Rapids has felt the growing pains associated with FIN 48 over the past several years and continues to do so as non-public companies become more familiar with the financial interpretation.

Financial statements from the greater Grand Rapids area were chosen because the area offers well-established public and private companies, a positive point when examining a financial interpretation which affects both public and non-public companies. Probable conclusions can be drawn in Grand Rapids because this area is greatly influenced by conservative-trending leaders, financially.

Though both Steelcase and Wolverine World Wide did have allowance accounts, the potential for material negative effects on financials as a result of an unfavorable IRS finding was small to non-existent. Projecting those findings on non-public companies, one would expect similar results among the non-public high-profile businesses and a lessened direct impact on smaller non-public companies.

The financially conservative nature of this area in comparison to other areas of the US means that the findings documented in this paper may vary greatly from research conducted in Silicon Valley, for example. A more risk-accepting company might translate that risk into bolder tax positions which would create a greater need for financial involvement from companies and auditors alike. That in turn would require more financial backing from companies to establish the dividing line of the MLTN criteria and to work toward ensuring proper disclosure of tax positions in the financial statements.

Alternatively, a larger city with a greater breadth of companies has the potential of vastly varying results within its own city limits. The effects of IRS audits may threaten financial statements greatly for one company and be immaterial for another. That is not to say that the possibility for this is eliminated by examining two public cities within the confines of greater Grand Rapids, Michigan, but the findings could be more readily projected to surrounding companies perhaps than some others.

Overall, the research available for FIN 48 is limited, though not in quantity. The majority of current research revolves around deciphering application and encouraging speculation rather than the documented effect of FIN 48 on a company. Cries against a road map for the Internal Revenue Service and an anticipated increase in legal fees, audits, and related costs have been heard across the board in response to FIN 48 but remain, at this time, undocumented in a relationary way to costs that existed prior to the adoption.

Companies have begun to experience increases in related costs, however. Public accounting firms have entered uncharted waters while waiting for FASB to produce a working outline for adopting FIN 48. These firms are putting time and money into creating workshops, fliers, and web-based resource tools which aim to inform their workforce about FIN 48.

The costs incurred by public accounting firms are then passed on to their clients as the accountants engage in activities such as researching tax positions taken in the past, creating workpapers for documentation, and meeting with company owners to discuss all tax positions and potential for a negative audit finding. These clients may also have chosen to bring tax experts or buy into those offering insurance against FIN 48 costs and effects or even train someone internally.

Documentation is easier said than done, as well. Public accounting firms are struggling enough to document tax positions in such a way that the documentation covers the necessary requirements but does not expose the firm's hand more than needed. Now add to it the difficulty in identifying these tax positions taken for auditors of companies whose tax accountants come from a rival accounting firm. The information regarding these positions is guarded and no one seems willing to let all of their tricks out of the bag at any point, law mandate or not.

These all impacted the findings documented of this paper. MLTN criteria calculations differ from company to company and have been kept out of public hands for comparison. Potential increases in costs have been recognized at the individual company level as well as in-house for public accounting firms but those numbers have not been published in a manner which allows an increase in costs to be directly attributed to the implementation of FIN 48.

Changes have been made regarding documentation requirements, mandatory implementation dates, and even naming of the financial interpretation itself. The beginning of the year found at least one accounting firm holding seminars from staff level through partner to discuss the very basic outline of the interpretation. Though clarity has not yet been disseminated from FASB through the financial world with regards to FIN 48, it does appear that the disclosures have been deemed acceptable thus far and it can be assumed that we will continue to see varied ways of documenting the required disclosures going forward.

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