



**Analysis of Financial Reporting Matters
Related to Auction Rate Securities**

A Huron Consulting Group Report

Huron's Analysis of Financial Reporting Matters Related to Auction Rate Securities

Findings Show Variability in Disclosures, Amounts, and Earnings Impact of Impairments of Auction Rate Securities

In February 2008, the market for Auction Rate Securities (ARS) effectively ceased when the vast majority of auctions failed and prevented holders from selling their investments. ARS are debt instruments with long-term maturities, supported by various underlying asset types. Investors generally considered ARS to be short-term, liquid investments because they could sell the securities periodically at auction.

The failed auctions and the resulting loss of liquidity caused significant financial reporting challenges as companies holding these securities were required to make judgments about complex issues related to fair value measurements, recognition of impairments, and appropriate disclosures. The illiquid market conditions intensified the focus on the quality of the underlying collateral, which may have been under additional pressure depending on the asset type.

Huron's purpose in studying this event, which reflects a microcosm of the broader credit crisis, was to highlight differences in disclosures and accounting treatments among registrants related to ARS. Huron used Form 10-Q and Form 10-K filings as well as Form 6-K filings by foreign private issuers to compile the data. This included risk and investment disclosures, changes in the fair value of the assets, if any, and the type of the underlying assets as well as balance sheet classifications, if disclosed, for registrants.

It is important to note that while registrants may have properly disclosed these events in accordance with generally accepted accounting principles and the applicable U.S. Securities and Exchange Commission (SEC) rules and guidance, the registrants' facts and circumstances and the evolving nature of the issues under consideration can result in significant diversity of information reported to the market.

impairment on an "other-than-temporary" basis and therefore recognized decreases in fair value in shareholders' equity (for securities classified as "available-for-sale"), other companies determined the loss in value was "other-than-temporary" and recognized a charge to earnings. Companies would have considered a number of factors, including ability and intent to hold the securities until values recover and the quality of the

Huron's database contains information, where disclosed, for over 600 registrants that reported investments in ARS during the first quarter of 2008, including:

- Risk and investment disclosures related to ARS
- Industry classifications for each registrant
- Fair value of ARS holdings at the report date
- Changes in the fair value of ARS during the period
- Type of impairment recorded, if any
- Classification and description of collateral underlying the ARS
- Accounting classification of ARS under SFAS 115
- Balance sheet classification at the report date

The accounting rules require the use of judgment in assessing investments for impairment. Applying those rules can result in different conclusions by companies holding the same asset because of differences in circumstances affecting those companies. Where some companies determined that the securities were not

underlying collateral, in determining the appropriate accounting for impaired securities. Substantially all of the companies in Huron's analysis classified ARS as "available-for-sale."

FASB Statement No. 157: Fair Value Measurements

Guidance

32. "For assets and liabilities that are measured at fair value...the reporting entity shall disclose information that enables users of its financial statements to assess the inputs used to develop those measurements..."

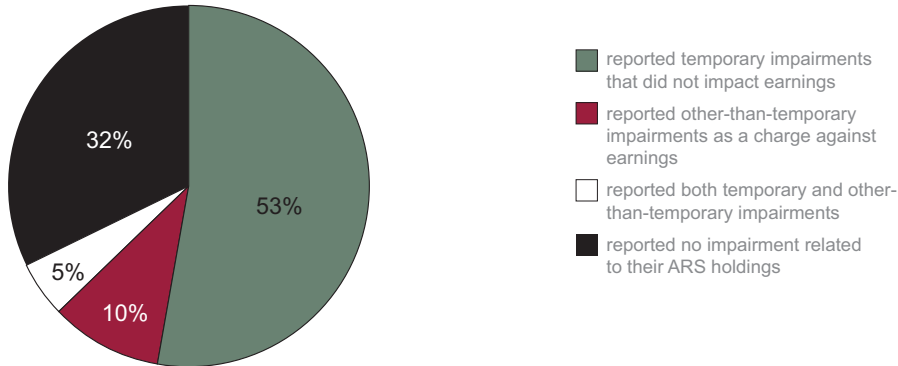
Disclosure Example

"The discounted cash flow model used to determine the fair value of the auction rate securities utilized two significant unobservable inputs: a discount rate of approximately 5.37% which represents an estimate[d] market rate of return and an estimated period until sale and/or successful auction of the security of five years. Based on the discounted cash flow model, the Company determined that the fair value of the auction rate security had declined by \$25 during the first quarter of 2008. The determination of the fair value of the auction rate security also considered, among other things, the collateralization underlying the individual securities and the creditworthiness of the counterparty...Accordingly, the Company wrote-down our auction rate security to its estimated fair value as of March 31, 2008 and recognized a charge of \$25, which is included in other income (expense), net, in the accompanying consolidated statement of operations."

KEY FINDINGS FROM HURON’S ANALYSIS INCLUDE

Similar Assets, Dissimilar Earnings Impact

Of the more than 600 registrants that reported ARS investments, approximately 90% disclosed making fair value assessments of ARS in the first quarter. Of those:



ARS Collateral Definitions Chart

Based on our review of registrants’ disclosures, we classified ARS holdings into the following categories, according to the chart below. In many situations, due to the limited information disclosed, we exercised judgment in classifying the ARS into the various categories.

Since the majority of registrants that disclosed more than one type of ARS did not provide discernable information for further categorizations, we classified these as “Multiple Collateral Types.” For registrants that did not provide any data regarding the collateral underlying their investments in ARS, we classified these as “Not Disclosed.”

Underlying Collateral Category	Criteria [A]	# of Registrants Reporting	Average Impairment as a % of FV
Student Loan	Companies that disclosed holding ARS with underlying collateral in student loans, including loans identified as guaranteed by the Federal government.	209	6%
Muni Bond	Companies that disclosed holding ARS with underlying collateral in municipal obligations.	59	5%
CDO	Companies that disclosed holding ARS with underlying collateral in Collateralized Debt Obligations (CDOs) (many of which were backed by one or more of the following types of underlying assets: short-term corporate notes and bonds; residential and commercial mortgages, including subprime; commercial paper; bank deposit notes; credit default swaps; debt obligations issued by banks and insurance companies; credit card loans; and money market issues).	18	20%
Closed-End Fund	Companies that disclosed holding ARS with underlying collateral in closed-end funds.	9	7%
Multiple Collateral Types	Companies that disclosed holding more than one type of ARS but which generally lacked discernable information to make further categorization readily available.	85	7%
Not Disclosed	Companies that disclosed holding ARS but did not specify any underlying collateral type.	166	10%

[A] Note: Criteria applied to companies that provided adequate information for our analysis related to their accounting treatment, including impairments.

Item 303 of Regulation S-K: Management’s Discussion and Analysis of Financial Condition and Results of Operations (MD&A)

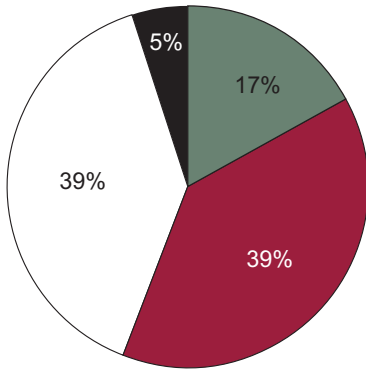
Guidance

(a)(1). “Identify any known trends or any known demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in the registrant’s liquidity increasing or decreasing in any material way...”

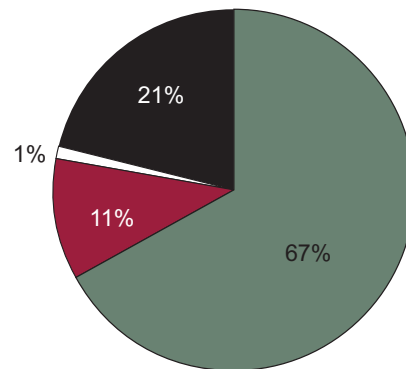
Disclosure Example

“Our ARS investments are intended to provide liquidity via an auction process that resets the applicable interest rate in the event there is no new investment in these securities. Due to recent uncertainty in the credit markets some of our holdings in our ARS investment portfolio have failed to settle on their respective settlement dates resulting in illiquidity in these investments. Consequently, we have not been able to access these funds and do not expect to do so until a future auction of these investments is successful or a buyer is found outside the auction process. Although the maturity dates of the underlying securities of our ARS investments range from 4 to 31 years, we currently have sufficient cash and cash equivalents, cash from operations and access to unused credit facilities to meet our short term liquidity requirements and do not anticipate that we will need to access our ARS investments for additional liquidity.”

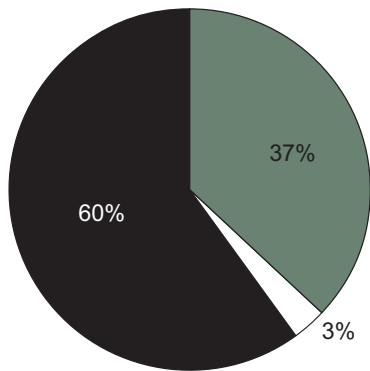
At the underlying asset level, registrants also reported variability in the type of impairment:



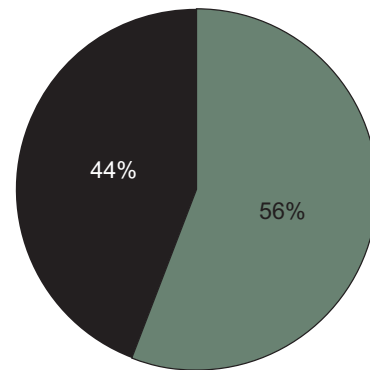
ARS backed by CDOs



ARS backed by student loans



ARS backed by municipal bonds



ARS backed by closed-end funds

- reported temporary impairments that did not impact earnings
- reported other-than-temporary impairments as a charge against earnings
- reported both temporary and other-than-temporary impairments
- reported no impairment related to their ARS holdings

FASB Statement No. 115: Accounting for Certain Investments in Debt and Equity Securities

Guidance

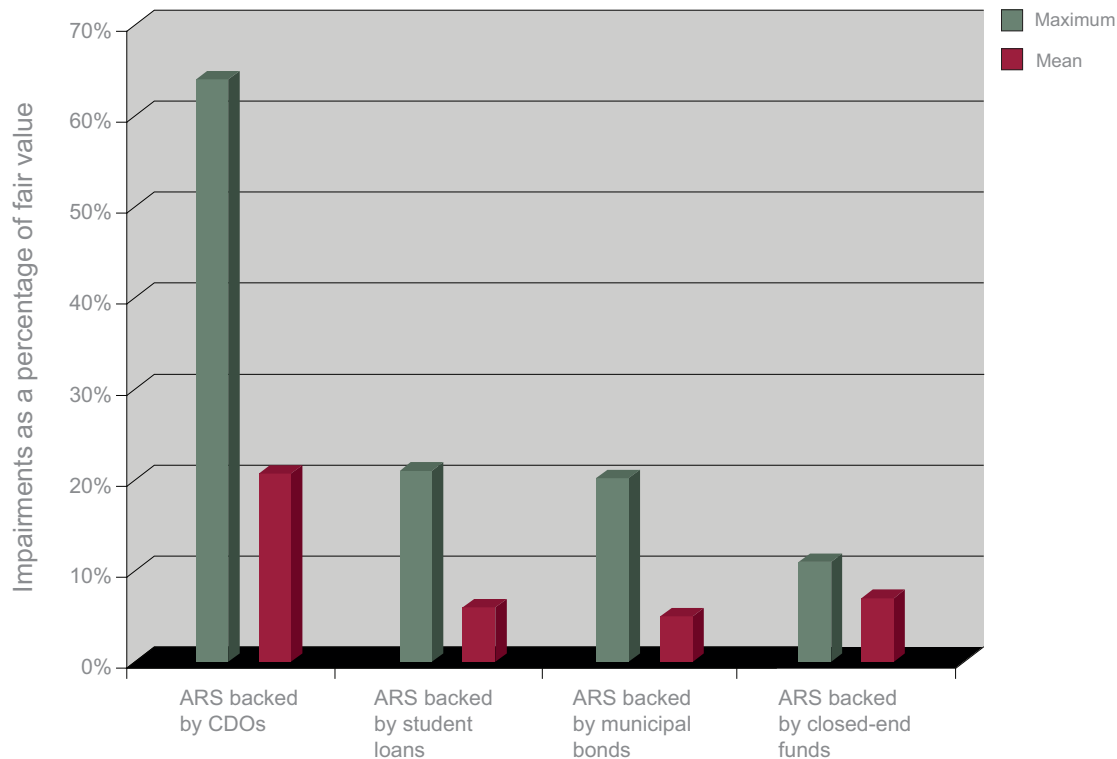
6. "At acquisition, an enterprise shall classify debt and equity securities into one of three categories: held-to-maturity, available-for-sale, or trading. At each reporting date, the appropriateness of the classification shall be reassessed."

Disclosure Example

"These investments are comprised primarily of readily marketable corporate debt securities, debt instruments of the U.S. government and its agencies and auction rate debt and preferred securities. We determine the appropriate classification of our investments at the time of acquisition and reevaluate such determination at each balance sheet date. Held-to-maturity securities are those investments that we have the ability and intent to hold until maturity. Held-to-maturity securities are recorded at amortized cost. Available-for-sale securities are recorded at fair value, with unrealized gains or losses recorded as a separate component of accumulated other comprehensive income (loss) in shareholders' equity until realized."

Wide Range of Fair Values

Within underlying asset classes, substantial differences were observed in the impairments reported



Loss of Liquidity Alters Current Ratios

Historically, ARS were classified on the balance sheet as short-term investments. As a result of the loss in liquidity for these assets, many registrants have reclassified ARS to long-term during the period reviewed:

- 41% of companies reporting balance sheet classifications for ARS changed their classification from short-term to long-term during the first quarter of 2008.
- 48% of companies holding ARS backed by municipal bonds, 18% of companies holding ARS backed by student loans, 26% of companies holding ARS backed by CDOs, and 40% of companies holding ARS backed by closed-end funds classified the ARS as current assets.

Some registrants reported risks in prior periods, but not many

Many registrants' filings for periods ending on or near December 31, 2007 acknowledged the auction failures. For this reason, Huron reviewed the immediately preceding filings of a subset of surveyed companies, which comprised nearly 70% of the total value of impairments reviewed. Of these companies, 58% disclosed holding ARS, 24% mentioned prior auction failures, and 15% actually reported impairments during the earlier period.

FASB Statement No. 115: Accounting for Certain Investments in Debt and Equity Securities

Guidance

16. "For individual securities classified as either available-for-sale or held-to-maturity, an enterprise shall determine whether a decline in fair value below the amortized cost basis is other than temporary. For example, if it is probable that the investor will be unable to collect all amounts due according to the contractual terms of a debt security not impaired at acquisition, an other-than-temporary impairment shall be considered to have occurred. If the decline in fair value is judged to be other than temporary, the cost basis of the individual security shall be written down to fair value as a new cost basis and the amount of the write-down shall be included in earnings (that is, accounted for as a realized loss). The new cost basis shall not be changed for subsequent recoveries in fair value..."

Disclosure Example

"The Company reviews for impairment in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and related guidance issued by the FASB and SEC in order to determine the classification of the impairment as 'temporary' or 'other-than-temporary.' ...An other-than-temporary impairment charge is recorded as a realized loss in the consolidated statement of operations and reduces net income (loss) for the applicable accounting period. The Company determined that the entire impairment related to its ARS was other than temporary and recorded an impairment charge in other income (expense) on its consolidated statements of operations."

A View Inside: ARS Challenges Companies Addressed

From: Jack R. Blank
Subject: Auction-Rate Securities Meeting Discussion Points
Date: August 15, 2008 8:45 PM CDT
To: Janet M. Palmer

Janet,

For tomorrow morning's meeting, I will bring broker statements, information from prior periods, some of Jeremy's questions about how we're going to handle this, and summaries of the guidance I have pulled together.

Below are the discussion points we should go over:

- "Intent and ability" of management to hold investments impacts accounting
- Quality of underlying assets varies within ARS categories
- Redemption potential may equate to auction liquidity
- Presence of guarantors reinforces value
- Needs for liquidity may impact investment decision
- Credit ratings weigh heavily in impairment assessment
- Valuation judgments must reflect the hypothetical "market participant"

See you at 9 AM. Just so I know in advance, will there be food? And is it okay if I invite Greg? Last point, you and I should agree on how we're going to treat this before we answer Gemma's questions.

Have a great night.

XYZ Company
 123 N ABC Street

88. "The Board also recognizes that the classification of investments in debt securities into three categories and the use of management intent as a criterion to distinguish among the categories present some difficulties. The classification of debt securities into three categories, each of which has different accounting, could result in comparability problems among enterprises. Enterprises with virtually identical securities may account for those securities differently. Additionally, basing the distinction in accounting treatment on management intent could result in an inconsistent application of the standard and contribute to comparability difficulties. Some constituents as well as some Board members question the relevance of accounting that results from using the intent of management as a criterion."

From Appendix of FAS 115 (as amended)

FASB Staff Position Nos. FAS 115-1 and 124-1: The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments

Guidance

13. "When the fair value of an investment is less than its cost at the balance sheet date of the reporting period for which impairment is assessed, the impairment is either temporary or other than temporary. An investor shall apply other guidance that is pertinent to the determination of whether an impairment is other than temporary, such as paragraph 16 of Statement 115 (which references SEC Staff Accounting Bulletin Topic 5M, *Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities*), paragraph 6 of Opinion 18, and EITF Issue No. 99-20, 'Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets'."

Disclosure Example

"The Company has concluded that the unrealized losses on these investments are temporary because (i) the Company believes that the decline in market value that has occurred is due to general market conditions, (ii) the auction rate securities continue to be of a high credit quality and interest is paid as due and (iii) the Company has the intent and ability to hold these investments until a recovery in market value occurs. The fair value of these securities could change significantly in the future and the Company may be required to record other-than-temporary impairment charges or additional unrealized losses in future periods."

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Huron Consulting Group assists corporations with complex accounting and financial reporting matters, financial analysis in business disputes and litigation, as well as valuation analysis related to business acquisitions. It is composed of certified public accountants, economists, certified fraud examiners, and holders of the Chartered Financial Analyst® designation who serve attorneys and corporations as consultants and expert witnesses in connection with business disputes, as well as in regulatory or internal investigations.

Huron also consults with companies in the areas of corporate governance, Sarbanes-Oxley compliance, internal audit, and corporate tax. Additionally, Huron provides experienced project leadership and credentialed, on-demand resources to assist companies with critical finance and accounting department projects.

Acknowledgments

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Companies wishing to learn more about Huron Consulting Group's services should contact Joseph J. Floyd at jfloyd@huronconsultinggroup.com or visit the company's website at: www.huronconsultinggroup.com.

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