Handout 1 — LOL Draft Income Statement and Excerpt From Tax Footnote as of December 31, 2010

LOL Corporation
CONSOLIDATED STATEMENT OF OPERATIONS

Years ended December 31, 2010, 2009, and 2008
(in thousands)

	2010	2009	2008
Revenues, net	2,000,000	1,900,000	1,800,000
Cost of goods sold	1,400,000	1,250,000	1,200,000
Gross profit	600,000	650,000	600,000
Selling, general, and administrative expense	500,000	500,000	400,000
Goodwill impairment	750,000	-	-
Operating income (loss)	(650,000)	150,000	200,000
Interest expense, net	50,000	50,000	50,000
Income (loss) before provision for income taxes	(700,000)	100,000	150,000
Provision (benefit) for income taxes	????	36,000	54,000
Net (loss) income	????	64,000	96,000

LOL Corporation
INVENTORY OF DEFERRED TAX BALANCES

The components of net deferred income taxes are as follows:

Year ended December 31, (In thousands)	**2010**	**2009**
Deferred income tax assets:		
Allowance for doubtful accounts	30,000	25,000
Tax loss carryforwards	100,000	100,000
Accruals and other	20,000	25,000
	150,000	150,000
Deferred income tax liabilities:		
Depreciation	(15,000)	(20,000)
Indefinite lived intangible assets (trademark)	(50,000)	(50,000)
Prepaid expenses	(30,000)	(20,000)
	(95,000)	(90,000)
Net deferred income taxes	55,000	60,000
Valuation allowance	????	-
Net deferred tax asset (liability)	????	60,000

At December 31, 2010, LOL had $270 million of net operating loss carryforwards. Of these, $15 million are capital losses and will expire in 2011, and the remaining $255 million are operating losses and will expire in 2025.

Handout 2 — LOL Deferred Tax Asset Realization Analysis Showing Pre-Tax Book Income Projections

LOL Corporation
Deferred Tax Asset Realization Analysis
(in thousands)

The documentation below was provided to the auditors as part of their audit.

Year	Pre-Tax Book Income (Loss)	Goodwill Impairment *	Adjusted Pre-Tax Book Income (Loss)
Actual Results			
2008	150,000		150,000
2009	100,000		100,000
2010	(700,000)	(750,000)	50,000
Projections			
2011	-		
2012	40,000		
2013	80,000		
2014	85,000		
2015	90,000		
2016	95,000		
2017	100,000		
2018	105,000		
2019	110,000		
2020	115,000		
2021	120,000		

* The goodwill impaired is nondeductible. There was no basis in the goodwill for tax purposes therefore the impairment had no direct impact on the tax provision. In other words, the impairment of the goodwill for book purposes does not result in a corresponding deduction for tax purposes in any period. The book expense, therefore, does not affect the resulting taxes payable and results in an effective tax rate that differs (unfavorably) from the statutory tax rate.

Handout 3 — Example of LOL Pre-Tax Income Forecast

Future projections are by their nature subjective. Projecting growth is more subjective as historic results may not have illustrated that such growth is attainable. As discussed above, LOL has negative evidence related to the impairment of goodwill and the cumulative losses over the three-year period. The loss of a significant customer as a result of bankruptcy may be considered objective negative evidence as well.

The adjusted historic results might provide evidence of future income. Such evidence might be persuasive enough to overcome the negative evidence. Assumptions related to growth in excess of historic results would be subjective and such subjective evidence might not be sufficient to overcome the objective negative evidence.

In this fact pattern, the adjusted income from the most recent year of $50 million would be most indicative of future results. The average adjusted income of $100 million may also be indicative of future results but would be less convincing evidence than the $50 most recent year as a result of the declining results.

In projecting future income, LOL might use actual expectations but then limit the expectations by the most recent year's results ($50 million) or the average of the most recent three years ($100 million). The projected income for this scenario might appear as follows:

Year	Pre-Tax Book Income (Loss)	Limited to $50 million	Limited to $100 million
Projections			
2011	-	-	-
2012	40,000	40,000	40,000
2013	80,000	50,000	80,000
2014	85,000	50,000	85,000
2015	90,000	50,000	90,000
2016	95,000	50,000	95,000
2017	100,000	50,000	100,000
2018	105,000	50,000	100,000
2019	110,000	50,000	100,000
2020	115,000	50,000	100,000
2021	120,000	50,000	100,000

All evaluations related to the projection of future taxable income should not be formulaic but should be based on information that is consistent with expectations and supportable on the basis of evidence both objective and subjective.

Handout 4 — Examples of PCAOB and SEC Comments

PCAOB Comments

The PCAOB, in evaluating compliance with the professional standards, has focused on the need to use professional skepticism when evaluating estimates made by management. An example of a comment made by the PCAOB regarding the evaluation of the need for a valuation is as follows:

> In evaluating the reasonableness of the issuer's assertion about the realizability of the Federal NOL deferred tax benefits, the engagement team failed to identify and evaluate all relevant elements of positive and negative evidence that existed at the time the engagement team issued its audit opinion and weight those elements of evidence on the basis of the extent to which such items were objectively verifiable.
>
> The engagement team's evaluation of the realizability of the Federal NOL deferred tax benefits relied on future projected income. Regarding the issuer's forecasted taxable income:
>
> 1. The engagement team failed to evaluate whether the issuer had the ability to forecast income over a XX-year period with a reasonable level of accuracy in light of the uncertain current and future economic environment and the lack of any formal board approved long-term strategic plan. While the engagement team back tested certain aspects of the issuer's forecast for 2008 (compared actual to forecast), it failed to test the issuer's ability to forecast income in the outer years. This was particularly important as the Federal NOL deferred tax benefits were only forecasted to begin realization during the Y year and fully realized in year Z.
>
> 2. The engagement team failed to sufficiently consider that cumulative losses are a form of negative evidence that is highly objectively verifiable and carries more weight than other evidence that embodies some degree of subjectivity. For this reason, whenever an enterprise has suffered cumulative losses in recent years, realization of a deferred tax asset is difficult to support if it is based on forecasts of future profitable results without a demonstrated turnaround to operating profitability. Not only did the issuer experience cumulative losses in the prior three years but the issuer projected cumulative losses in the initial forecasted three-year period in both the normal and extreme scenarios, which increased the level of subjectivity of the projections presented as positive evidence.

Other negative evidence existed that the engagement team either failed to evaluate, or to which the engagement team failed to assign appropriate weight in its evaluation of positive and negative evidence, and included but was not limited to the following:

- The current deep economic recession and lack of clarity regarding future prospects for an economic turnaround in the U.S. economy.
- The categorization by the engagement team of the negative evidence associated with the credit crisis as only being "subjective."
- The uncertainty over potential future regulatory changes facing the X-industry sector, including the potential for regulatory actions related to the issuer in light of its continuing losses.
- The issuer had forecasted a projected cumulative loss in the first three-year period because of continuing credit losses, and the issuer has not shown an ability to forecast future credit losses.

SEC Comments

Examples of SEC comments on the topic are as follows:

- We note during the fourth quarter of fiscal year 20X1, you recognized a full valuation allowance against your remaining net U.S. deferred tax assets in the amount of $X million because of "several significant developments, which occurred during the fourth quarter of fiscal year [20X1]." Considering the significant impact this charge had on your results, it is unclear why you did not provide a comprehensive discussion regarding this charge within your footnotes and within MD&A. Please provide us with the following:

    - A detailed explanation of each of the factors that occurred during the fourth quarter of fiscal year 20X1 that led to such a material charge.
    - What you mean by the statement, "$X million of which is an adjustment to the beginning-of-year valuation allowance as a result of changes of circumstances, which caused a change in judgment regarding the realizability of the net U.S. deferred tax assets."

  As part of your response, please tell us how you intend to revise your disclosures in future filings with regard to the fourth quarter of fiscal year 20X1 and the first quarter of fiscal year 20X2 charges to recognize a full valuation allowance on your net U.S. and Italian deferred tax assets.

- You did not disclose why you believe that a valuation allowance is not necessary on the deferred tax asset of $X million related to your credit default swap financial guarantees. Please disclose within MD&A all of the positive and negative factors that you considered and the reasons that you concluded that it is more likely than not that the $X million in deferred tax assets will be realized. Please refer to paragraphs 20–25 of Statement 109 (as codified in ASC 740) for guidance. Please also disclose the status of the federal income tax treatment of credit default swaps, whether it is a settled or unsettled area of tax law, and the possible range of outcomes that may result because of this uncertainty.

We note your disclosure on page x that you expect to record significant net losses for a number of years as a result of the amortization of finite lived intangibles and non-cash equity based compensation. In light of your expected losses, please revise your filing to describe how you considered paragraph 23(b) of Statement 109 (as codified in ASC 740) in determining that no valuation allowance was necessary on $X million deferred tax assets as of December 31, 20X1.