

CORPORATE EXECUTIVE BOARD  
*Finance Practice*

VALUATION AND ACCOUNTING  
FOR FAILED AUCTION RATE SECURITIES  
*Early Findings and Outlook on Emerging Practices*



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## WITH SPECIAL THANKS

The Roundtable would like to extend its thanks to

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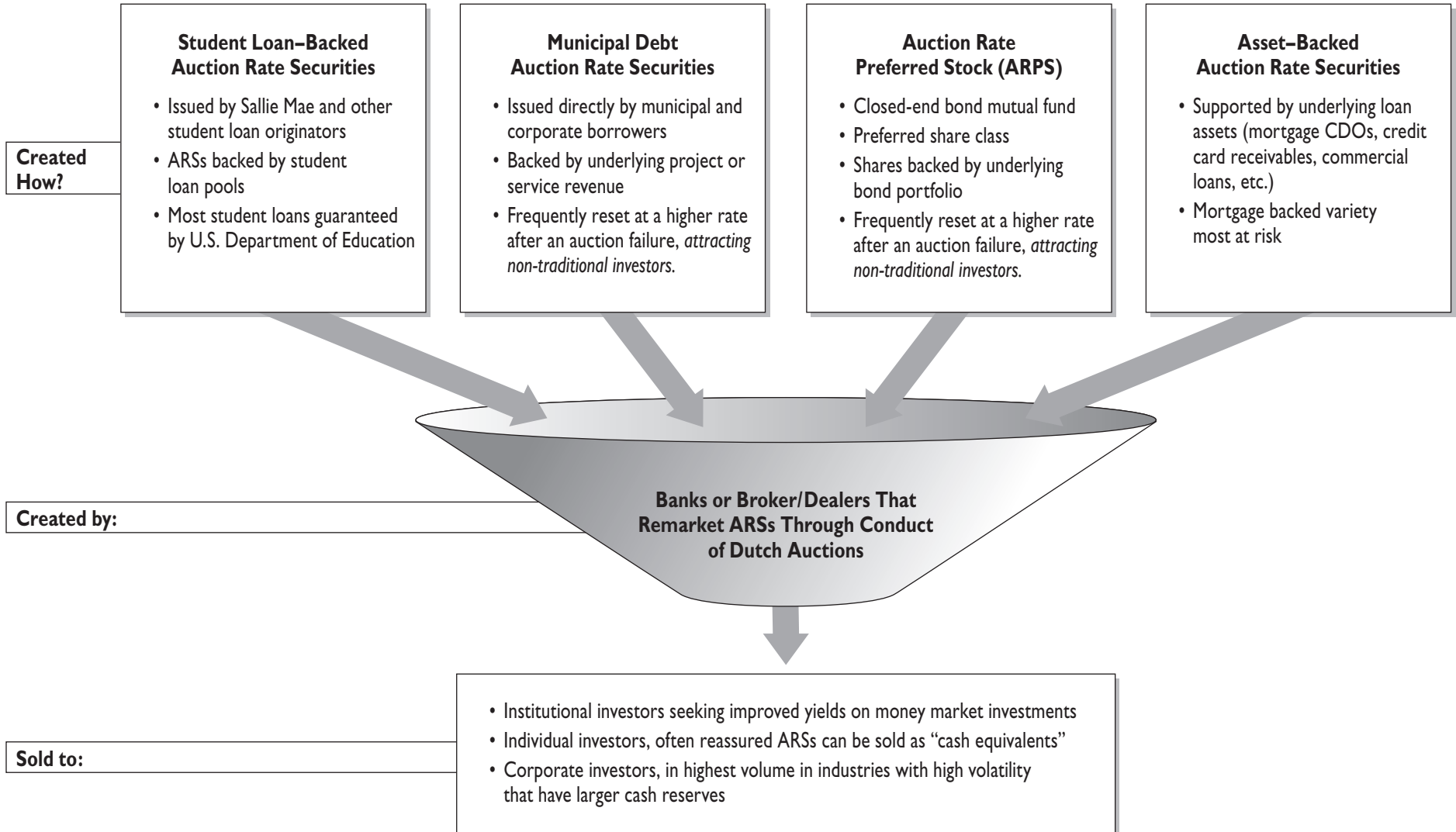
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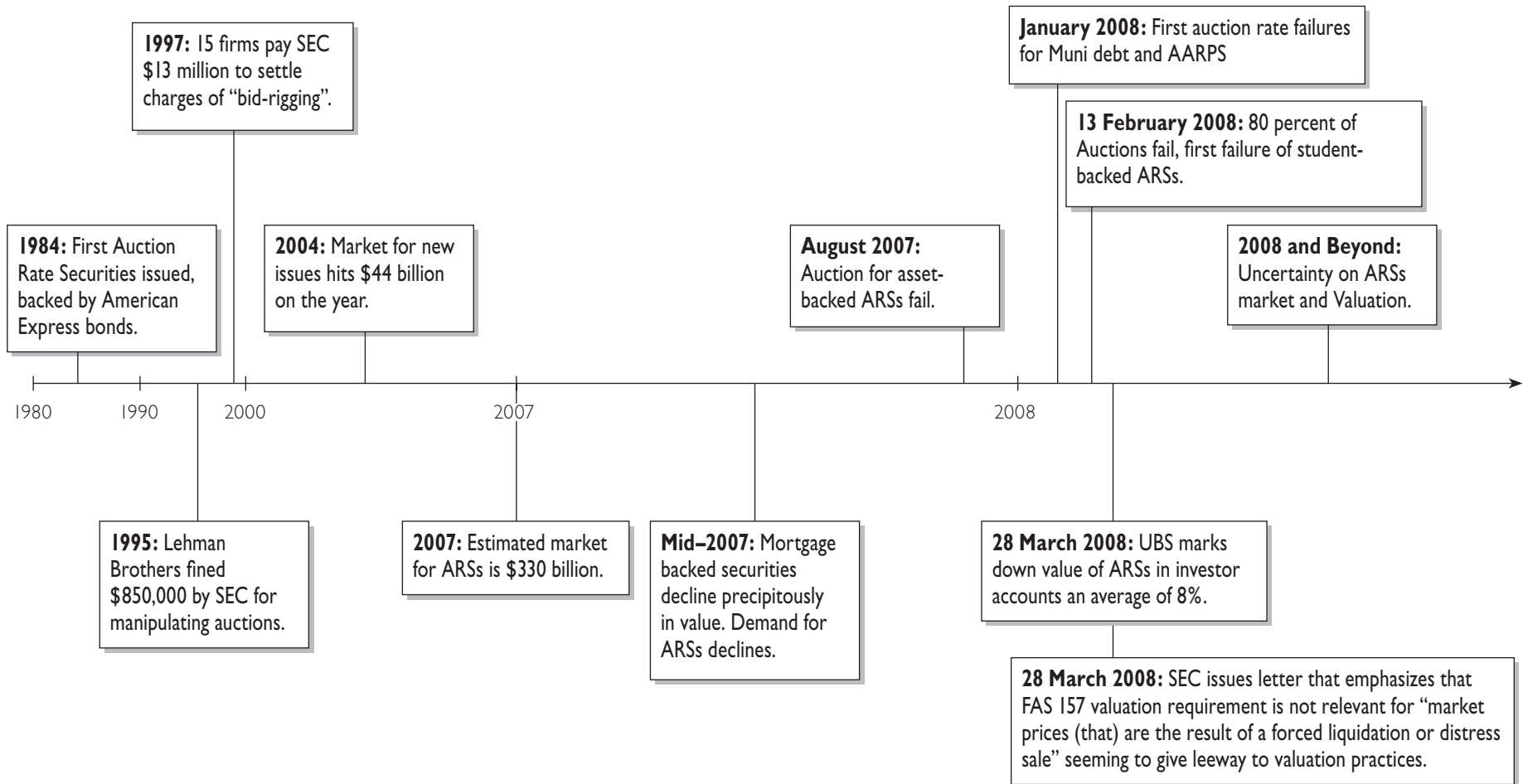
# TYPES OF AUCTION RATE SECURITIES

## Three Layers of Risk Transfer



# HOW DID WE GET HERE?

A Timeline of Auction Rate Securities  
*Key Dates in ARSs Evolution, 1984–2008*



Source: US Securities and Exchange Commission; www.wsj.com; www.wikipedia.com; Conner, Mark, Corporate Treasury Investment Consulting LLC; Corporate Executive Board Finance Practice research.

## FAS 157 AND IMPLICATIONS FOR ARSs

### FAS 157 Valuation Input “Levels” Overview

*Key Points from the Guidance*

Level	Valuation “Mechanism”	Explanation of Valuation “Inputs” at Each Level	ARS Implication
1	Market Activity	<ul style="list-style-type: none"> <li>Quoted prices (unadjusted) in active markets for identical assets or liabilities at the measurement date</li> <li>Transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis</li> </ul>	Most ARSs can no longer be valued at Level 1 since some auctions have failed and no prices currently exist.
2	Market Activity	<ul style="list-style-type: none"> <li>Inputs other than quoted prices included within Level 1</li> <li>Inputs observable for the asset or liability, either directly or indirectly</li> <li>Quoted prices for similar in active markets</li> <li>Quoted prices for identical or similar in markets that are not active</li> <li>Interest rates and yield curves</li> <li>Inputs that are derived principally from or corroborated by observable market data by correlation or other means (market-corroborated inputs)</li> </ul>	Some ARSs can be valued with Level 2 inputs, depending on availability of inputs. Successful auctions of similar ARS may validate this level and a par valuation.
3	Assumptions about Market Activity	<ul style="list-style-type: none"> <li>Unobservable inputs, used only to the extent that observable inputs are not available</li> <li>Must reflect an exit price from the perspective of a market participant who holds the asset or owes the liability</li> <li>Inputs reflect the reporting entity’s own assumptions about the assumptions that market participants would use in pricing the asset or liability</li> <li>Reporting entities should include market participant assumptions that are reasonably available without undue cost and effort</li> </ul>	Some ARS will be valued at Level 3 inputs due to lack of available market information.

The SEC in its letter of 28 March seems to validate classifying ARSs as level 3: “Current market conditions may require you to use valuation models that require significant unobservable inputs for some of your assets and liabilities. As a consequence, as of 1 January 2008, you will classify these assets and liabilities as Level 3.”

Source: FASB Statement No. 157, Financial Accounting Standards Board; Conner, Mark, Corporate Treasury Investment Consulting LLC; Corporate Executive Board Finance Practice research.

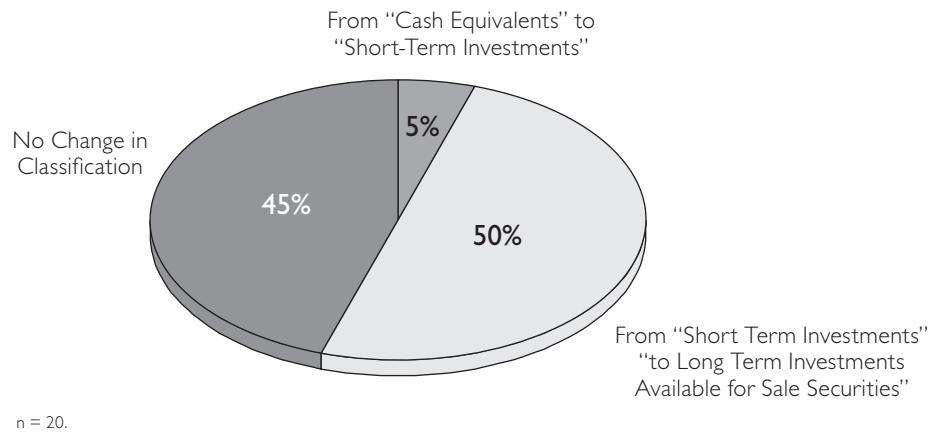
## TEMPORARY OR OTHER THAN TEMPORARY?

**Half of companies holding Auction Rate Securities are reclassifying them as long-term investments...**

**... but few companies are taking other than temporary impairments (OTTI) for their entire portfolio of ARSs**

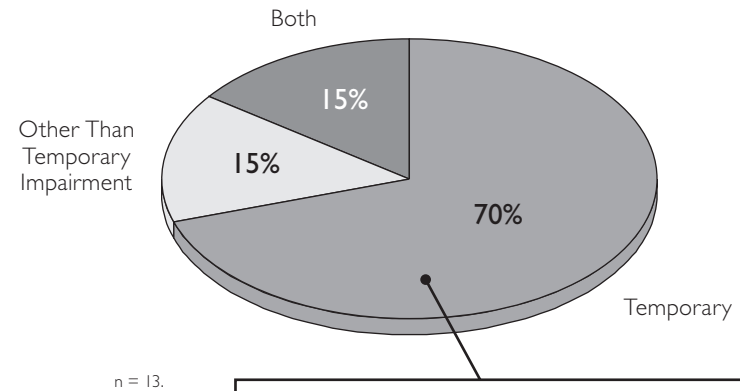
Reclassification of Auction Rate Securities\*

Percentage of Respondents, April 2008



Type of Impairment Taken or Planned\*

Percentage of Respondents, April 2008



### Arguments Made for Temporary Classification

- Strength of Supporting Investments
- Ability to Hold to Maturity
- Intent to Hold to Maturity
- Unprecedented Market Conditions

### GOOD TIMES WILL COME AGAIN

"We plan to reclassify them as 'long-term investments' and report the impairment as temporary. Most of our ARSs are AAA rated, U.S. government backed, student loans. We have said that we have the ability and intent to hold on to these until they recover their value."

Energy Company

\* Most responses represent expected reporting and are therefore not yet audited.

Source: Corporate Executive Board Finance Practice research.

## GRASPING AT STRAWS

**Many ARS holders are unsure whether to value them using Level 2 or Level 3 inputs under SFAS157...**

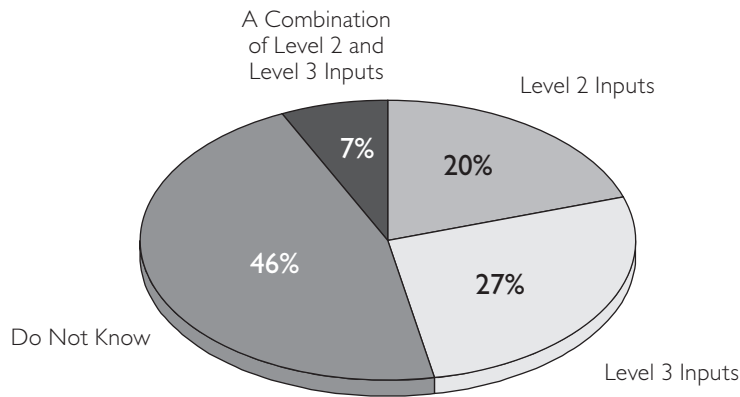
**...and a variety of valuation methods are, or will be, used**

Types of Inputs Used to Value ARSs<sup>1</sup>

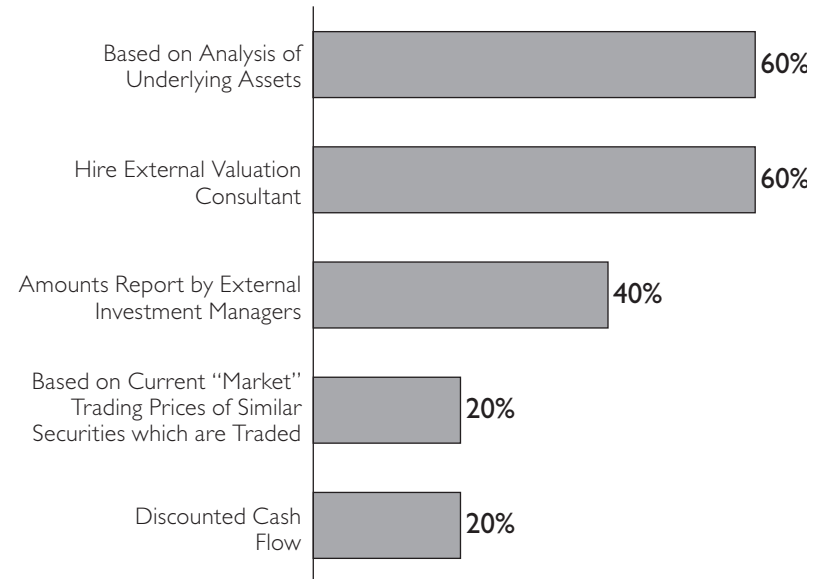
Percentage of Respondents, April 2008

Planned Method(s) for Calculating Impaired ARSs<sup>2</sup>

Percentage of Respondents, Multiple Responses Allowed, April 2008



n = 15.



n = 5.

<sup>1</sup> Most responses represent expected reporting and are therefore not yet audited.

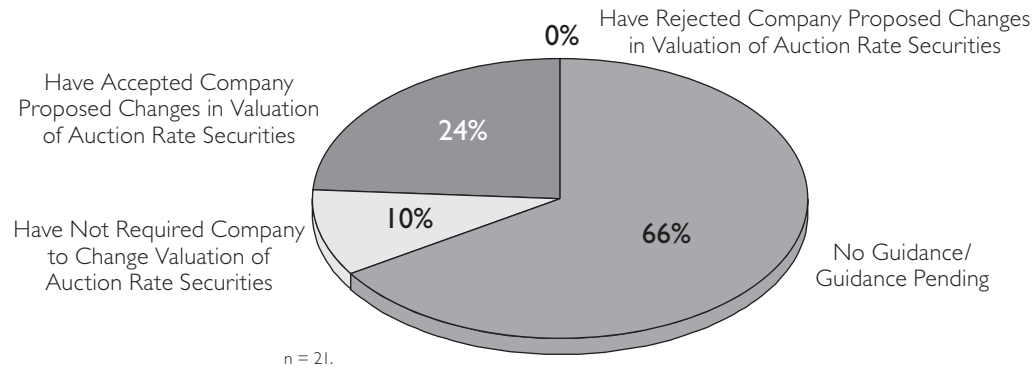
<sup>2</sup> Based on limited sample size.

## IN THE DARK

### Most Companies Have Not Yet Received Guidance from Auditors Regarding Valuation of Auction Rate Securities

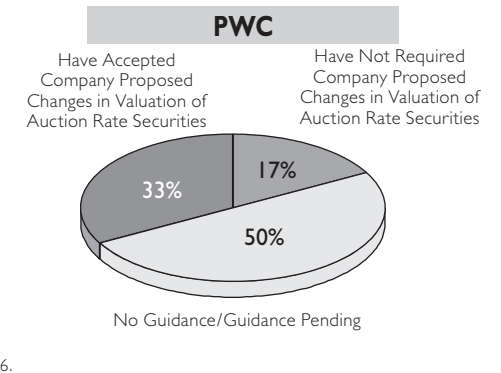
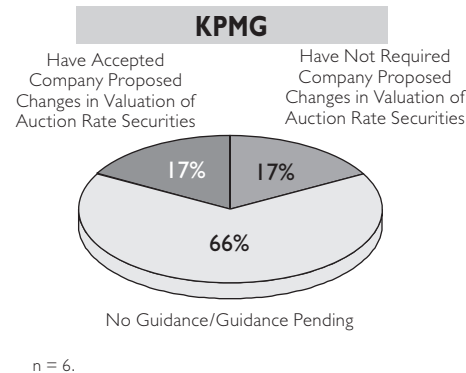
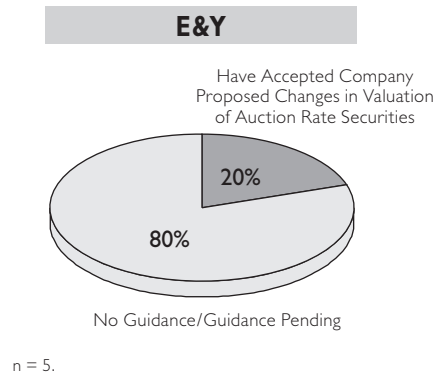
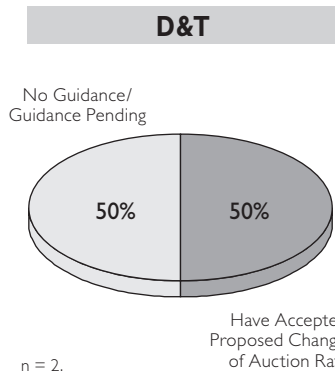
Auction Rate Securities Guidance Offered by External Auditor<sup>1</sup>

Percentage of Respondents, April 2008



Auction Rate Securities Guidance Offered by Specific External Auditors<sup>2</sup>

Percentage of Respondents, April 2008



### BLIND LEADING THE BLIND

“Lots of talk, but no clear guidance; (our auditors) are as clueless as we are.”

Manufacturing Company

<sup>1</sup> Most responses represent expected reporting and are therefore not yet audited.

<sup>2</sup> Based on limited sample size.  
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## DIFFERING VIEWPOINTS

### **Arguments Exist for Temporary Impairment, but Some Are More Conservative Regarding Expectations for Future Auction Rate Securities Liquidity**

#### Rationale for Treatment of Impairment

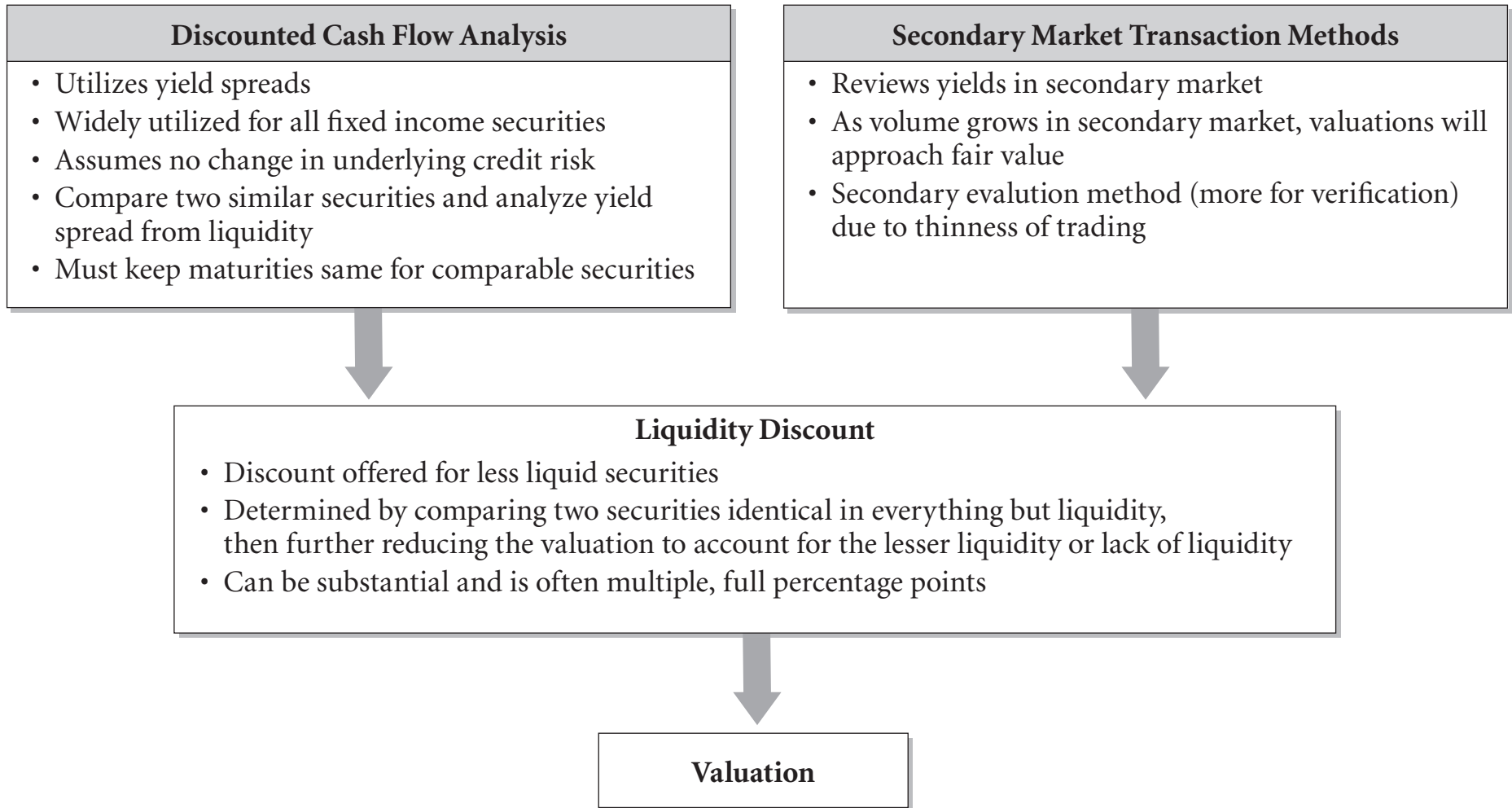
Arguments by Companies Treating as Temporary	Arguments by Companies Treating as OTTI
<p><b>Specific Valuation Guidelines</b></p> <p>“We consider impairment policy, nature of the holdings, ability to hold to maturity, and unprecedented market conditions.”                      -Electronics Company</p>	<p><b>Specific Valuation Guidelines</b></p> <p>“We consider time in loss position, analysis of ‘other than temporary’ impairment factors, including projected future cash flows, credit ratings actions and assessment of credit quality of underlying collateral. We also consider guidance in EITF 03-1, FSP SFAS 115-1 and 124-1.”                      -Consumer Products Company</p>
<p><b>Nature of the Collateral</b></p> <p>“The collateral behind the investment has not defaulted and is still strong. Additionally, we expect to reach the full par amount.”</p>	<p><b>Better Safe Than Sorry</b></p> <p>“Our company just wanted to take a very conservative approach.”                      -Technology Company</p>
<p><b>Follow the Pack</b></p> <p>“We see the potential to record a temporary impairment based on recent announcement by UBS on lowering the value of investor accounts. We would report a temporary impairment, because we believe we will be able to fully collect the interest and principle of the municipal bonds and student loans.”                      -Retail Company</p>	<p><b>Move On</b></p> <p>“Although held as available for sale, I do not expect a recovery to take more than six months. Therefore, I would rather talk about it one time, not twice (now, then again six months from now).”                      -Electronics Company</p>
<p><b>Expected Recovery</b></p> <p>“The underlying credit (student loans) has not deteriorated and is government-backed, and the company has the ability and intent to hold the securities to maturity.”                      -Pharmaceutical Company</p>	
<p><b>Expected Recovery</b></p> <p>“Current indications are that we have little or no impairment. If we do, it would be temporary as we have the ability and intent to hold to maturity (under FSP FAS 115-1 and 124-1).”                      -Electronics Company</p>	

Source: Corporate Executive Board Finance Practice research.

## OPTIONS FOR VALUATION

Possible Valuation Techniques

*Illustrative*



Source: Robak, Espen, *Finance Leadership Exchange and Pluris Valuation Advisors LLC Presentation*, March 24, 2008; Conner, Mark, *Corporate Treasury Investment Consulting LLC*; Corporate Executive Board Finance Practice research.

## WHAT'S NEXT ON ARS?

### Investment Provider Relationship Management

**“What should companies communicate to their provider?”**

Make sure your investment provider knows that on any auction date relevant in your portfolio that you are a seller. This standing “sell” order will help to ensure that you don’t miss a chance to sell, should one arise.

Be sure to request that your investment provider relays to you any reports of any successful liquidations and their executed prices, if such information becomes available. This will support balance sheet valuations and raise your awareness of liquidation opportunities, including between auctions.

**“What should they expect from their provider?”**

Your provider should be prepared to extend to you a secured or collateralized borrowing facility on favorable terms (though this may not be possible in the case of most fee-based money managers).

Your provider should work to seek bids on your ARS, even between auctions. There are now numerous precedents for ARS trading in secondary market transactions and at prices other than par. Ask your provider specifically for “firm bids” on your bonds and be prepared to decide quickly to sell if they furnish acceptable bids—in a “work-out” market like the current one, bids are only considered good for a brief time, usually intraday at the longest.

Your provider should be willing and, indeed, must, support “trades away.” This means that if your company should succeed in finding a willing buyer that is not your provider (while giving your provider an equal shot at bidding), your provider should make every effort to facilitate that trade and to avoid encumbering your ability to execute it.

Your provider should be expected to support your auditors near quarter-end. The audit folks will have lots of questions and many of the answers can only be obtained from the provider.

**“What other things can they do to receive favorable treatment?”**

Be sure to use any leverage available to you. If your company has an investment banking relationship with your investment provider, call the bankers and make sure they are apprised of your account situation. Your investment account contacts likely will be very reluctant to volunteer this information to their banker colleagues but your investment bankers may choose to intervene in order to preserve their relationship with your company.

## WHAT'S NEXT ON ARS?

### Possible Pitfalls

**“What should companies avoid doing with their Auction Rate Securities?”**

Don't “shop” your ARS. “Shopping” your ARS means seeking valuation or outright bids for your bonds from multiple sources at different times. This will create confusion and the illusion of greater supply.

Don't “ACAT” (Automated Customer Account Transfer) or otherwise transfer your securities from your provider out of spite. Many (most) ARS are dealer-proprietary and most money managers prefer to deal with the proprietary originators of ARS, as you should, believe it or not. Further, moving your ARS elsewhere will not improve your chances for liquidating them and can actually impair them for any period of time that your securities are in transit.

Be aware that some firms may try to convince you to transfer your failed ARS (along with any viable auction ARS) to their shop as they claim they can best help you. In reality, they may just be eager to capture the commission stream associated with all ARS.

Finally, avoid new or unproven trading venues, for now. ARS trade among established broker/dealer firms and they are still best equipped to facilitate transactions should you be able to sell successfully in any secondary market. New trading channels that purport to provide liquidity for ARS are in reality only facilitating private sales of these securities, like selling your millions of dollars of ARS on eBay.

**“Okay, is it ever appropriate to move ARSs?”**

Yes, but only under the following conditions:

- You have successfully arranged to sell them through another provider.
- You have been compelled to do so as part of a securitized borrowing facility.
- Your provider becomes insolvent and you are directed to transfer your securities to a trustee-nominated custodian.

## WHAT'S NEXT ON ARS?

### Auditor Response

**“How consistent are auditors (within a given firm and across firms) in their approach to impairment issues with ARS right now?”**

No more or less consistent than they were when ARS were reclassified in 2005!

Actually, it's somewhat a binary issue – under FAS 115, impaired means simply that an investment's market value is less than its cost. Further, 115 suggests that an impairment period of more than twelve months should be viewed as “other than temporary.” Where auditors will tussle with clients is over the issue of pricing and that will be a challenge as currently there are no reliable price sources for failed ARS.

I believe it will be up to companies to choose what definition of “other than temporary” impairment under FAS 115 best suits their circumstances and best suits shareholder interests. It is my own view that the current situation is temporary because there is no diminution of creditworthiness among nearly all ARS issuers, they all have access to the capital markets where they can propagate refinancing solutions, and they are highly motivated to do so. I agree that 115's guidelines that suggest an impairment period of more than twelve months should be viewed as “other than temporary” as I believe that market-based solutions for issuers can be effected within that time frame, notwithstanding the implications for greater issuance volume. For these reasons, I believe it is not imprudent to deal with unrealized losses in shareholder equity and to leave earnings alone until such time that it is more certain what outcome for ARS can be reasonably anticipated.

### Expectations for the Future of ARS

**“What do you think is the future of the ARS market?”**

The ARS market succeeded in terms of its liquidity promise for over twenty years. The recent crisis however is a liquidity crisis that was caused when dealers were forced to no longer bid at auction to support them. While it may be a bit unfair to say that the dealer community abandoned the ARS market, they did fail to inform investors starting in the Fall of 2007 that there was ever increasing selling that they were absorbing. Auction backstopping by dealers turned out to be a far more important source of liquidity than should have ever been the case. Further, the largest class of buyers and the class of buyers that bought ARS in the largest lots was corporations and their institutional memory is long. If at some point corporate investors stop remembering this event, their auditors will be sure to remind them. Knowing that still highly creditworthy issuers have numerous financing alternatives available to them, I believe the ARS market is all but dead.

## WHAT'S NEXT ON ARS?

**“How much do you think we can expect banks to put up their own capital to successfully close upcoming auctions, since most failed auctions are 95%+ complete?”**

I have not heard that statistic. While there may be some auctions that are “95%+ complete”, I’d be surprised to learn that a majority of auctions fit this characterization. Keep in mind that a failed auction may be that close to viability only because there is a single holder of the majority or all of that specific security. In such cases, the holder (including dealers) can submit simultaneous sell and buyer orders so as to create the illusion that there is demand from new buyers. This action is motivated by the fact that for as long as an auction hasn’t technically failed (though there is no real liquidity), it does not have to be treated as an impaired security and thus has no balance sheet impact. I have been told that dealers are doing this in cases where they own all of a specific security. Having said all that, I do believe there is a chance, given overall credit pressure relief, that dealers could again elect to backstop selected auctions for select issuers and to salvage relationships with certain investor clients. This is where your companies indirect pressure can help.

**“Do you see most companies moving out of ARS and/or ABS altogether (at least for cash investment)?”**

Yes, and I believe that this is the prudent thing to do now, especially for cash investors and public companies (it has long been my view that mortgage backed securities were never an acceptable vehicle for corporate cash accounts.) The position that I have seen among some cash investors that there could be some deals among asset backed issues not tied to residential mortgages is a dangerous one. If a corporate cash investor were to move out of RMBS and buy, say, credit card or commercial loan backed issues, what happens in a protracted recession?

**“How do you think the rating agencies are going to change their approach given how badly they misjudged the riskiness of many asset-backed securities?”**

Being careful not to seem to be defending the ratings agencies, this is a tricky one. The ratings companies assigned ratings based in part on repayment projections furnished by the investment banks. These data comported to what the agencies themselves said would be required to earn specific ratings but ultimately their reliability was the responsibility of the originators, not the ratings agencies. These data were of course shaky projections at best given the state of mortgage underwriting practices that we now know were lousy. Nevertheless, I believe that the ratings agencies should consider creating a separate scale altogether for asset backed instruments. This is already done for short-term instruments versus long term and I think it would be useful to have a separate ratings approach altogether for instruments whose repayment schedule is unpredictable, as is the case with nearly all asset backed instruments. Further, it would be useful if the ratings entities would also furnish contingent ratings based on varying repayment scenarios. I’m certain that the ratings companies are considering addressing these concerns and I’m hopeful their solutions will comprise these kinds of considerations.



## APPENDIX

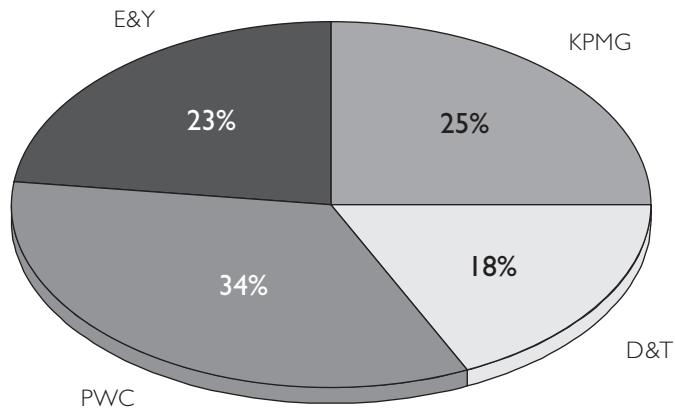
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### *Additional Findings from Corporate Executive Board*

- ☛ Additional Results from Auction Rate Securities Survey
- ☛ Current Auction Rate Securities-Related Filings

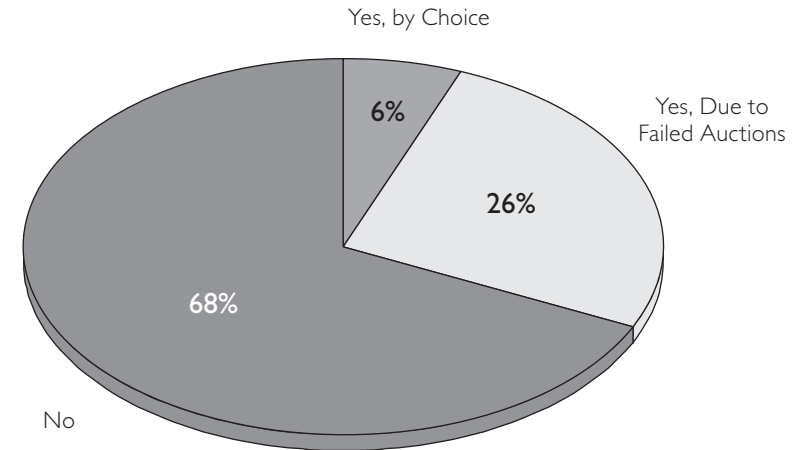
## DEAD WEIGHT

Respondent Profile of External Auditors  
 Number of Respondents, by Industry, April 2008



n = 61.

Rationale for Companies Holding ARSs  
 Percentage of Respondents, April 2008



n = 65.

### KEEP YOUR DISTANCE

“No, we have not had an ARSs program...it is now doubtful that we will ever pursue an ARSs program—at least not very soon.”

Energy Company

Source: Corporate Executive Board Finance Practice research.

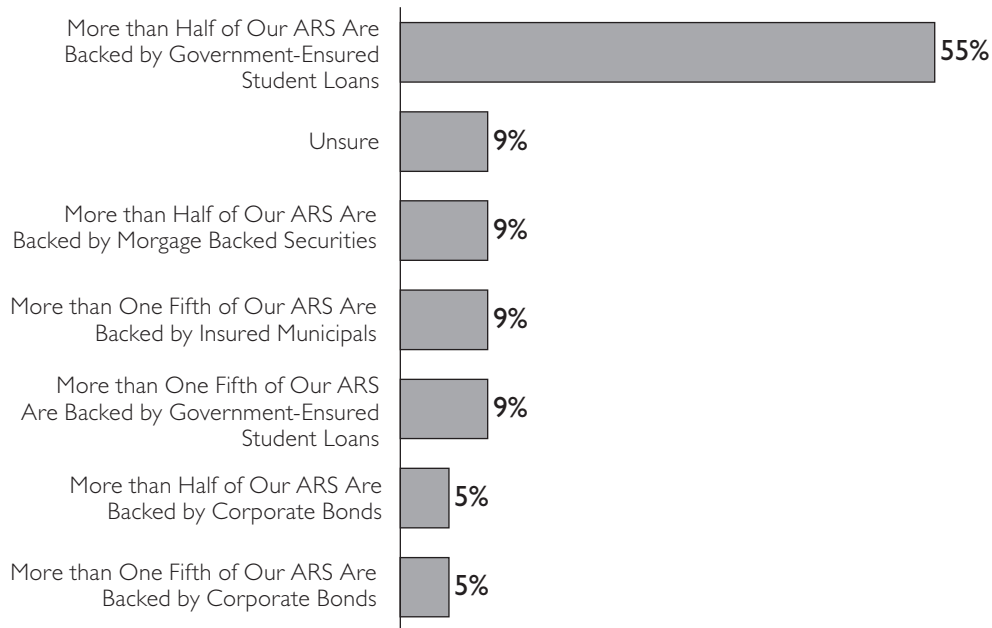
## NO SAFE HARBOR

**Student loans back most remaining ARSs holdings...**

**...but companies experience high failure rates for ARSs backed by all types of available asset classes**

Composition of ARSs Holdings

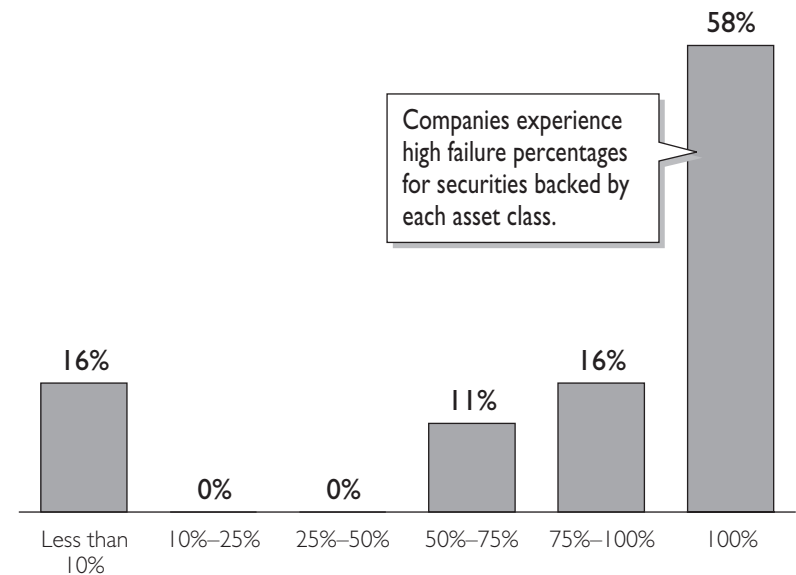
Percentage of Respondents, April 2008



n = 22.

Percentage of Auction Rate Securities that Failed at Auction

Percentage of Respondents, April 2008



n = 19.

### DON'T PANIC?

“We are carrying at par due to the high quality of the underlying credit.”  
 Manufacturing Company

Source: Corporate Executive Board Finance Practice research.

## CURRENT ARS-RELATED FILINGS (10-K)

### **Palm Inc.**

**Date: 4/7/2008**

**Revenue: \$1.5 billion**

We hold a variety of interest bearing auction rate securities, or ARS, that represent investments in pools of assets, including commercial paper, collateralized debt obligations, credit linked notes and credit derivative products. These ARS investments are intended to provide liquidity via an auction process that resets the applicable interest rate at predetermined calendar intervals, allowing investors to either roll over their holdings or gain immediate liquidity by selling such interests at par. The recent uncertainties in the credit markets have affected all of our holdings in ARS investments and auctions for our investments in these securities have failed to settle on their respective settlement dates. Consequently, the investments are not currently liquid and we will not be able to access these funds until a future auction of these investments is successful or a buyer is found outside of the auction process. Maturity dates for these ARS investments range from 2017 to 2052 with principal distributions occurring on certain securities prior to maturity. All of the ARS investments were investment grade quality and were in compliance with our investment policy at the time of acquisition. We currently have the ability and intent to hold these ARS investments until a recovery of the auction process or until maturity. As of November 30, 2007 (the end of the second quarter of fiscal year 2008), we reclassified the entire ARS investment balance from short-term investments to non-current auction rate securities on our condensed consolidated balance sheet because of our inability to determine when our investments in ARS would settle. We have also modified our current investment strategy and increased our investments in more liquid money market investments.

Typically the fair value of ARS investments approximates par value due to the frequent resets through the auction process. While we continue to earn interest on our ARS investments at the maximum contractual rate, these investments are not currently trading and therefore do not currently have a readily determinable market value. Accordingly, the estimated fair value of ARS no longer approximates par value.

We have used a discounted cash flow model to determine the estimated fair value of our investment in ARS as of February 28, 2008. The assumptions used in preparing the discounted cash flow model include estimates for interest rates, timing and amount of cash flows and expected holding periods of the ARS. Based on this assessment of fair value, as of February 28, 2008 we determined there was a decline in the fair value of our ARS investments of \$39.2 million, of which \$13.7 million was deemed temporary and \$25.5 million was recognized as a pre-tax other-than-temporary impairment charge.

We review our impairments 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”. A temporary impairment charge results in an unrealized loss being recorded in the other comprehensive income (loss) component of stockholders’ equity. Such an unrealized loss does not affect net income (loss) for the applicable accounting period. An other-than-temporary impairment charge is recorded as a realized loss in the condensed consolidated statement of operations and reduces net income (loss) for the applicable accounting period. In evaluating the impairment of any individual ARS, we classified such impairment as temporary or other-than-temporary. The differentiating factors between temporary and other-than-temporary impairment are primarily the length of the time and the extent to which the market value has been less than cost, the financial condition and near-term prospects of the issuer and our intent and ability to retain our investment in the issuer for a period of time sufficient to allow for any anticipated recovery in market value.

## **American Eagle Outfitters**

**Date: 4/2/2008**

**Revenue: \$2.8 billion**

On 2 February 2008, the Company had a total of approximately \$786 million in cash and cash equivalents, short-term and long-term investments, which included approximately \$418 million of investments in auction rate securities (“ARS”). Beginning 12 February 2008 through 25 March 2008, the Company has experienced failed auctions for 36 ARS issues representing principal and accrued interest in the total amount of \$272.5 million. During this time, we have also sold nine ARS issues, at par plus accrued interest, for a total of \$36.6 million. We believe that the current lack of liquidity relating to our ARS investments will have no impact on our ability to fund our ongoing operations and growth initiatives. As of 25 March 2008, our ARS portfolio totaled approximately \$373 million. This amount includes approximately 46% federally insured student loan backed securities, 41% municipal and education authority bonds and 13% dividend received auction rate preferred securities.

Our ARS portfolio is comprised of approximately 69% AAA rated investments, 20% AA rated investments and 11% A rated investments. Based on our belief that our ARS investments can be liquidated through successful auctions or redemptions at par plus accrued interest, and on our ability and intent to hold such investments until liquidation, we believe that the current illiquidity of these investments is temporary. However, we will reassess this conclusion in future reporting periods based on several factors, including the success or failure of future auctions, possible failure of the investment to be redeemed, deterioration of the credit ratings of the investments, market risk and other factors. Such a reassessment may change the classification of these investments to long-term or result in a conclusion that these investments are impaired. If we determine that the fair value of these auction rate securities is temporarily impaired, we would record a temporary impairment within other comprehensive income, a component of stockholders’ equity. If it is determined that the fair value of these securities is other-than-temporarily impaired, we would record a loss in our Consolidated Statements of Operations, which could materially adversely impact our results of operations and financial condition.

## CURRENT ARS-RELATED FILINGS (10-K)

### Foot Locker Inc.

**Date: 4/1/2008**

**Revenue: \$5.8 billion**

The Company's auction rate security investments are accounted for as available-for-sale securities. The following represents the composition of the Company's auction rate securities by underlying investment.

	2007	2006 (in millions)
Tax exempt municipal bonds	\$--	\$44
Equity securities	5	205
	\$5	\$249

With the liquidity issues experienced in the global credit and capital markets, the Company's preferred stock auction rate security, having a face value of \$7 million, has experienced failed auctions. The Company determined that a temporary impairment has occurred and therefore has recorded a charge of \$2 million, with no tax benefit, to accumulated other comprehensive loss as of 2 February 2008. This security will continue to accrue interest at the contractual rate and will be auctioned every 90 days until the auction succeeds. Based on the relatively small size of this investment and the Company's ability to access cash and other short-term investments, and expected operating cash flows, we do not anticipate the lack of liquidity on this investment will affect our ability to operate our business as usual.

### HCA Inc.

**Date: 3/28/2008**

**Revenue: \$25.5 billion**

At 31 December 2007, our wholly-owned insurance subsidiary, had invested \$725 million in municipal, tax-exempt student loan auction rate securities and \$20 million in preferred stock auction rate securities which were classified as long-term investments. The auction rate securities ("ARS") are publicly issued securities with long-term stated maturities for which the interest rates are reset through a Dutch auction every 35 to 92 days. The auctions have historically provided a liquid market for these securities as investors could readily sell their investments at auction. With the liquidity issues experienced in global credit and capital markets, the ARS held by our wholly-owned insurance subsidiary have experienced multiple failed auctions, beginning on 11 February 2008, as the amount of securities submitted for sale exceeded the amount of purchase orders.

There is a very limited market for the ARS at this time. We do not currently intend to attempt sell the ARS as the liquidity needs of our insurance subsidiary are expected to be met by other investments in its investment portfolio. If uncertainties in the credit and capital markets continue or there are ratings downgrades on the ARS held by our insurance subsidiary, we may be required to recognize other-than-temporary impairments on these long-term investments in future periods.

## CURRENT ARS-RELATED FILINGS (10-K)

### **Pinnacle Airlines Corp.**

**Date: 3/17/2008**

**Revenue: \$790 million**

We invest in auction rate securities (“ARS”) that provide for an interest rate reset through a “dutch auction” process in periods spanning from seven to 35 days (See Note 16 in Item 8 of this Form 10-K for additional ARS related information). In February 2008 when our invested balance approximated \$136 million, auctions of our ARS failed to generate enough demand to successfully reset interest rates. We must either hold the securities until the next successful auction or attempt to sell the securities through a privately-placed secondary market transaction; until such time we are earning a contractual maximum interest rate on each security.

We are monitoring the ARS market closely. While we wait for both the ARS market to rationalize and for investor demand to return, we have arranged for a margin loan facility for a total of up to \$60 million (the “Term loan”) to be used to support our aircraft purchases and other liquidity needs, which we believe will be sufficient to supplement our cash flows from operations and meet our other current liquidity needs. Because of the unprecedented events in the ARS market, we cannot predict when liquidity in the ARS market will return. Although we believe our securities continue to represent good investments due to the AAA/Aaa credit ratings of the underlying investments, we may be forced to sell some of our ARS portfolio under distressed, illiquid market conditions, which could result in our recognizing a loss on such sales. In addition, we may reclassify all or a portion of our ARS portfolio as long-term investments, and we may record an impairment charge in future periods if we determine that the decline in value of our ARS portfolio is other-than-temporary or will not recover before we sell the investment.

### **Bowne and Co., Inc.**

**Date: 3/12/2008**

**Revenue: \$850 million**

The recent uncertainties in the credit markets have prevented the Company and other investors from liquidating some holdings of auction rate securities in recent auctions because the amount of securities submitted for sale has exceeded the amount of purchase orders. Accordingly, the Company still holds these auction rate securities and is receiving interest at a higher rate than similar securities for which auctions have cleared. These investments are insured against loss of principal and interest. In addition, the underlying securities or the monoline insurers have credit ratings of A–AAA, as rated by Standard and Poor’s.

Based on our ability to access cash and other short-term investments, our expected operating cash flows and our other sources of cash, we do not anticipate the current lack of liquidity of these investments will have a material effect on our liquidity or working capital.

## CURRENT ARS-RELATED FILINGS (10-K)

### **Cypress Semiconductor Corp.**

**Date: 3/3/2008**

**Revenue: \$1.6 billion**

Our investment portfolio includes auction rate securities, which are investments with contractual maturities generally between 20 to 30 years. They are usually found in the form of municipal bonds, preferred stock, a pool of student loans or collateralized debt obligations whose interest rates are reset every seven to 49 days through an auction process. At the end of each reset period, investors can sell or continue to hold the securities at par. The auction rate securities held by us are primarily backed by student loans and are over-collateralized, insured and guaranteed by the United States Federal Department of Education. In addition, all auction rate securities held by us are rated by the major independent rating agencies as either AAA or Aaa.

Most of these auction rate securities were scheduled to reset subsequent to 30 December 2007. As of 28 February 2008, a portion of our auction rate securities have failed auctions, and we expect that the remaining auction rate securities will fail, due to sell orders exceeding buy orders. These failures are not believed to be a credit issue, but rather caused by a lack of liquidity. Under the contractual terms, the issuer is obligated to pay penalty rates should an auction fail. In the event we need to access the funds associated with failed auctions, they are not expected to be accessible until one of the following occurs: a successful auction occurs, the issuer redeems the issue, a buyer is found outside of the auction process or the underlying securities have matured.

We determined that no other-than-temporary impairment losses existed as of 30 December 2007 as all holdings had successful auctions. However, if the issuer of the auction rate securities is unable to successfully close future auctions or does not redeem the auction rate securities, or the United States government fails to support its guaranty of the obligations, we may be required to adjust the carrying value of the auction rate securities and record other-than-temporary impairment charges in future periods, which could materially affect our results of operations and financial condition.

### **Cypress Semiconductor Corp.**

**Date: 3/3/2008**

**Revenue: \$1.6 billion**

The Company invests in auction rate securities which effectively mature every 28 days. Upon maturity, the proceeds are reinvested in the same security. The effective maturity date differs from the stated maturity dates. The securities are classified in the balance sheet at their stated maturity dates.

## CURRENT ARS-RELATED FILINGS (10-K)

### **Ceradyne, Inc.**

**Date: 2/26/2008**

**Revenue: \$660 million**

Our long term investments are subject to risks which may cause losses and affect the liquidity of these investments. Our long term investments at 31 December 2007 included \$38.1 million of auction rate securities net of a temporary impairment charge of \$0.8 million against other comprehensive income and an other than temporary impairment charge of \$2.1 million against current earnings. The Company's investments in auction rate securities represent interests in collateralized debt obligations supported by pools of residential and commercial mortgages or credit cards, insurance securitizations and other structured credits, including corporate bonds. These auction rate securities are intended to provide liquidity via an auction process that resets the applicable interest rate at predetermined calendar intervals, allowing investors to either roll over their holdings or gain immediate liquidity by selling such interests at par. During the second half of the year 2007, the auctions for these securities failed. As a result of current negative conditions in the global credit markets, auctions for our investment in these securities have recently failed to settle on their respective settlement dates. Consequently, the investments are not currently liquid through the normal auction process. If they remain illiquid, and a buyer is not found outside the auction process, the value of these securities may decline further. We review impairments associated with the above in accordance with Emerging Issues Task Force (EITF) 03-1 and FSP SFAS 115-1 and 124-1, "The Meaning of Other-Than-Temporary-Impairment and Its Application to Certain Investments," to determine the classification of the impairment as "temporary" or "other-than-temporary." A temporary impairment charge results in an unrealized loss being recorded in the other comprehensive income component of stockholders' equity. Such an unrealized loss does not reduce net income for the applicable accounting period because the loss is not viewed as other-than-temporary. We believe that a portion of the impairment of our auction rate securities investments is temporary and a portion is other-than-temporary. Our business is subject to various laws and regulations favoring the U.S. government's contractual position, and our failure to comply with such laws and regulations could harm our operating results and prospects. As a contractor to the U.S. government, we must comply with laws and regulations relating to the formation, administration and performance of federal government contracts that affect how we do business with our customers and may impose added costs on our business. These rules generally favor the U.S. government's contractual position. For example, these regulations and laws include provisions that allow unsuccessful bidders to protest or challenge contracts we have been awarded, and allow the government to unilaterally terminate, reduce or modify our government contracts. The Company's short term investments consist of marketable securities, primarily high-grade corporate and government securities. The Company's long term investments consist of auction rate securities. The Company classifies its investments as available-for-sale based on the Company's intent. As of 31 December 2007, the amount classified as available for sale is \$29.6 million, which is recorded at fair market value. Our long term investments at 31 December 2007 included \$38.1 million of auction rate securities net of a temporary impairment charge of \$0.8 million against other comprehensive income and an other than temporary impairment charge of \$2.1 million against current earnings. The Company's investments in auction rate securities represent interests in collateralized debt obligations supported by pools of residential and commercial mortgages or credit cards, insurance securitizations and other structured credits, including corporate bonds. These auction rate securities are intended to provide liquidity via an auction process that resets the applicable interest rate at predetermined calendar intervals, allowing investors to either roll over their holdings or gain immediate liquidity by selling such interests at par. During the second half of the year 2007, the auctions for these securities failed. As a result of current negative conditions in the global credit markets, auctions for the Company's investment in these securities have recently failed to settle on their respective settlement dates. Consequently, the investments are not currently liquid through the normal auction process and may be liquid when a buyer is found outside of the auction process.

Source: Livedgar ([www.gsonline.com](http://www.gsonline.com)); U.S. Securities and Exchange Commission; Corporate Executive Board Finance Practice research.

## CURRENT ARS-RELATED FILINGS (10-K)

### **Global Industries Ltd.**

**Date: 2/26/2008**

**Revenue: \$1.2 billion**

Our investments in auction rate securities may be adversely impacted by Liquidity Risks. We have invested a portion of our cash in auction rate securities. Our investments in auction rate securities may be adversely impacted by relatively illiquid markets. Our ability to sell these securities may be impaired due to the recent increase in failed auctions. We may not be able to liquidate these securities in the immediate future or may be forced to sell them for less than what we might have otherwise have been able to, or both. Liquidity Risks: The credit markets are currently experiencing significant uncertainty, and some of this uncertainty has impacted the markets where auction rate securities of municipalities that we have invested in would be offered. We are unable to estimate the impact, if any, which emerging credit market conditions may have on the liquidity of our investment in auction rate securities. We do not believe any reduction in liquidity of our investment in auction rate securities will have a material impact on our overall liquidity. We believe the \$99.9 million carrying value of the auction rate securities we owned at 31 December 2007 is not impaired, but we may have to reclassify the investment from short-term to long-term investments if future liquidity conditions mandate. Marketable Securities - We have invested in municipal-based auction rate securities which are debt and preferred stock instruments having longer-dated legal maturities (in most cases, many years), but with interest rates that are generally reset every 28–49 days under a Dutch auction system. Because we regularly liquidate our investments in these securities for reasons including, among others, changes in the availability of and the yield on alternative type investments, we have classified these securities as available-for-sale. The coupon interest rate for these securities outstanding at 31 December 2007 ranged from 4.25% to 5.90%, on a tax-exempt basis. Short-term marketable securities are carried at cost, which approximates fair value. Management determines the appropriate classification of its investments in debt and equity securities at the time of purchase and re-evaluates such determination at each balance sheet date. Investments classified as available-for-sale are carried at an estimated fair value with any unrealized gain or loss recorded in accumulated other comprehensive income. There was no unrealized gain or loss associated with the auction rate securities that were outstanding at 31 December 2007.

## CURRENT ARS-RELATED FILINGS (10-K)

### **Office Depot Inc.**

**Date: 2/26/2008**

**Revenue: \$15 billion**

Short-term Investments: We held no short-term investments at 29 December 2007 or 30 December 2006. When held, investments in debt and auction rate securities were classified as available-for-sale and reported at fair market value, based on quoted market prices using the specific identification method.

### **The Williams Companies**

**Date: 2/26/2008**

**Revenue: \$12 billion**

Auction rate securities: Auction rate securities are instruments with long-term underlying maturities, but for which an auction is conducted periodically, as specified, to reset the interest rate and allow investors to buy or sell the instruments. Because auctions generally occur more often than annually, and because we hold these investments in order to meet short-term liquidity needs, we classify auction rate securities as short-term and include them in other current assets and deferred charges on our Consolidated Balance Sheet. Our Consolidated Statement of Cash Flows reflects the gross amount of the purchases of auction rate securities and the proceeds from sales of auction rate securities.

## CURRENT ARS-RELATED FILINGS (10-K)

### **Quest Software**

**Date: 2/25/2008**

**Revenue: \$560 million**

We invest our cash balances in high-quality issuers and, limit the amount of credit exposure to any one issuer other than the United States government and its agencies. Our investments in marketable securities consist of United States Government and its Agency Bonds, Auction Rate Municipal securities and Commercial Paper. Our municipal auction rate securities are investment grade quality and are in compliance with our investment policy as of the end of 2007. We believe that these investments still approximate their par value however, such risks, including the systemic failure of future auctions for auction rate securities, may result in a loss of liquidity, substantial impairment to our investments, realization of substantial future losses, or a complete loss of the investment in the long-term which may have a material adverse effect on our business, results of operations, liquidity, and financial condition. Our investments in marketable securities consist of United States Government and Government Agency Bonds, auction Rate Municipal securities and Commercial Paper. Unrealized losses from our investment in U.S. government agency mortgage-backed securities are primarily attributable to changes in interest rates. We do not believe any unrealized losses represent other-than-temporary impairments based on our evaluation of available evidence as of these dates. We have the intention and ability to hold such securities until the maturity dates.

At 31 December 2007, we held \$50.3 million of municipal notes with an auction reset feature (“auction rate securities”). These securities are collateralized by higher education funded student loans, \$22.5 million par amount of which are supported by the federal government as part of the Federal Family Education Loan Program (FFELP) and the remaining securities are backed by monoline insurance companies. The Dutch auction process that resets the applicable interest rate at predetermined calendar intervals is intended to provide liquidity to the holder of auction rate securities by matching buyers and sellers within a market context enabling the holder to gain immediate liquidity by selling such interests at par or rolling over their investment. If there is an imbalance between buyers and sellers the risk of a failed auction exists. We have not experienced a failed auction for any of our securities as of 31 December 2007. However, we had three issues fail at auction on 14 February 2008 with a par value of \$0.9 million. Given the deteriorating credit markets, and the increased incidence of failure within the auction market in February 2008, there can be no assurance as to when we would be able to liquidate a particular issue. In such case of a failure we would not be able to access those funds until a future auction of these investments is successful, the security is called by the issuer or a buyer is found outside of the auction process. Furthermore, if this situation were to persist despite our ability to hold such investments until maturity, we may be required to record an impairment charge at a future date. We will continue to monitor and evaluate these investments as there is no assurance as to when the market for this investment class will return to orderly operations. As such, we believe that the anticipated recovery period for these investments may be longer than twelve months and as a result we have reclassified these investments from short-term to long-term marketable securities at 31 December 2007. Interest income, included in other income (expense), net in the accompanying consolidated income statements, was \$18.1 million, \$11.2 million and \$6.8 million for the years ended 31 December 2007, 2006, and 2005, respectively.

## CURRENT ARS-RELATED FILINGS (10-K)

### **UST Inc.**

**Date: 2/22/2008**

**Revenue: \$1.9 billion**

Concentration of Credit Risk: The Company routinely invests portions of its cash in short-term instruments deemed to be cash equivalents. It is the Company's policy to ensure that these instruments are comprised of only investment grade securities (as determined by a third-party rating agency) which mature in three months or less. These factors, along with continual monitoring of the credit status of the issuer companies and securities, reduce the Company's exposure to investment risk associated with these securities. At 31 December 2007, the Company had approximately \$57.4 million invested in these instruments. Short-term investments at 31 December 2006 of \$20 million were comprised of auction rate securities ("ARS"), which are long-term variable (floating) rate bonds that are tied to short-term interest rates. The stated maturities for these securities are generally 20 to 30 years, but their floating interest rates are reset at seven, 28 or 35-day intervals via a Dutch Auction process. Given the fact that ARS are floating rate investments, they are typically traded at par value, with interest paid at each auction. There were no short-term investments at 31 December 2007.

### **MDU Resources Group Inc.**

**Date: 2/20/2008**

**Revenue: \$4 billion**

Short-term investments: The Company had auction rate securities of \$91.6 million and \$23.3 million at 31 December 2007 and 2006, respectively, which are long-term variable rate bonds tied to short-term interest rates that are reset through an auction process which typically occurs every 90 days or less. The Company accounts for these investments as available-for-sale in accordance with SFAS No. 115. Due to the short interest rate reset period, the fair value of the auction rate securities approximates cost and, as a result, there are no accumulated unrealized gains or losses recorded in accumulated other comprehensive income on the Consolidated Balance Sheets related to these investments.

### **Clarcor Inc.**

**Date: 1/28/2008**

**Revenue: \$920 million**

Short-term investments include auction rate securities and variable rate demand notes classified as trading securities. These securities are carried at fair value, with unrealized holding gains and losses, if any, reported in investment income. There were no unrealized holding gains or losses in any year presented.

## CURRENT ARS-RELATED FILINGS (10-K)

### **Verigy Ltd.**

**Date: 12/27/2007**

**Revenue: \$760 million**

Funds associated with certain of our auction rate securities may not be accessible for in excess of 12 months and our auction rate securities may experience an other than temporary decline in value, which would adversely affect our income. Our marketable securities portfolio, which totals \$402 million at 31 October 2007, includes auction rate securities of \$142 million (at cost). Auction rate securities are securities that are structured with short-term interest rate reset dates of generally less than ninety days, but with contractual maturities that can be well in excess of ten years. At the end of each reset period, which occurs every seven to thirty-five days, investors can sell or continue to hold the securities at par. In the fourth quarter of fiscal year 2007, certain auction rate securities with a cost value of \$49 million failed auction due to sell orders exceeding buy orders. Based on an analysis of other-than-temporary impairment factors, we recorded a temporary impairment within other comprehensive loss, a component of shareholders' equity, of approximately \$1.4 million (net of tax of \$0.3 million) at 31 October 2007 related to these auction rate securities. Although we believe that the decline in the fair market value of these securities is temporary, there is a risk that the decline in value may ultimately be deemed to be other than temporary. In the future, should we determine that the decline in value of these auction rate securities is other than temporary, it would result in a loss being recognized in our statement of operations, which could be material. The funds associated with failed auctions will not be accessible until a successful auction occurs, a buyer is found outside of the auction process or the underlying securities have matured. As a result, we have classified those securities with failed auctions as long-term assets in our consolidated balance sheet. Other auction rate securities within our investment portfolio at 31 October 2007 with a cost value and carrying value of \$93 million continue to auction as scheduled and are classified as current assets on our consolidated balance sheet. If conditions in the credit markets deteriorate further causing auctions to fail on these securities, the funds associated with these securities may also not be accessible for in excess of 12 months.

### **Mother Work Inc.**

**Date: 12/14/2008**

**Revenue: \$580 million**

The Company's short-term investments as of 30 September 2007 were classified as available-for-sale and consisted exclusively of auction rate securities with the cost equal to the fair value. These securities had liquidity provisions at specified interest rate reset dates, typically every 7, 28 or 35 days, and the original maturity of the securities was beyond three months. There were no realized gains or losses associated with available-for-sale investments in fiscal 2007, 2006, or 2005.