



Financial Accounting Standards Board

Board Meeting Handout Financial Statement Presentation

March 12, 2008

Note: the paragraph and issue numbers in this handout correspond to paragraph numbers in the Board memoranda used as the basis for discussion.

ISSUE 1: VIEWS ON THE PRESENTATION OF INCOME TAX

2. The following paragraphs are from a draft of the discussion document and summarize the Boards' view (from September 2006) on how income taxes should be presented in the financial statements and why.

DP1. When discussing the presentation of income taxes in the financial statements, the Boards considered whether income taxes should be viewed as integral to the transaction or event that gives rise to income taxes (the underlying transaction) or as unrelated to the underlying transaction and related to the entity as a whole.

DP2. Those who hold the view that income taxes **are integral** to the underlying transaction note that presenting income tax information in the same category as the related transaction helps a user better assess the effectiveness of management's decisions, as the decision of whether to enter into a transaction is often made after considering the income tax consequences. Under this view, income taxes would be allocated to the categories/sections in the statement of comprehensive income (operating, investing, financing assets, financing liabilities, discontinued operations, equity, and foreign currencies).

DP3. Those who are of the view that income taxes **are not integral** to the underlying transaction note that income taxes are a form of income appropriation. Tax authorities levy taxes on an entity's taxable

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income. The amount due tax authorities is determined based on formulas promulgated by tax authorities, which may rely heavily on, but is nonetheless independent from, information presented in the financial statements. Under this view, income taxes would be presented in a separate section.

- DP4. In considering that latter view, the Boards noted that presenting income taxes in a separate section is consistent with the working format categories/sections that reflect the functions or activities of an entity. Most entities manage their taxes as a separate function, for the entity as a whole. In line with that notion, the Boards noted that some components of an entity's income tax expense or benefit (such as loss carryforwards) might not be directly related to any one specific transaction recognized in the statement of comprehensive income.

Existing Guidance on Intraproduct Tax Allocation

- DP5. In forming their view on this issue, the Boards considered the detailed guidance on intraproduct tax allocation that is in FASB Statement No. 109, *Accounting for Income Taxes*. While the guidance in Statement 109 is detailed enough that the allocated amounts can be calculated unambiguously, the Boards noted that the rules themselves are somewhat arbitrary and in some cases the allocated amounts are not useful to users of financial statements. For example, Statement 109 requires that an entity allocate the effect of a change in income tax rates to income from continuing operations regardless of the asset or liability to which the change relates. Accordingly, any income tax amount related to other comprehensive income (OCI) items would not be adjusted for a change in income tax rates and the income tax amount allocated to continuing operations would include taxes related to income earned from continuing operations as well as taxes due to a change in tax rates. In those instances, the amount reported for accumulated OCI might be misleading, as might be the after-tax amount reported for continuing operations.

Boards' Preliminary View

- DP6. For the reasons noted above, the Boards' preliminary view is that an entity should present income taxes in a separate section in each of the financial statements. Based on this preliminary view:
- a. The income tax section of the statement of financial position would include all current and deferred income tax assets and liabilities recognized pursuant to Statement 109 and IAS 12, including taxes related to transactions with owners.
 - b. The income tax section of the statement of cash flows would include all cash payments and receipts for income taxes.
 - c. The income tax section of the statement of comprehensive income would include all current and deferred income tax expense (or benefits).
 - i. Amounts presented in all other sections (the business section, financing section, and discontinued operations section) would be pretax amounts, eliminating the need for intraperiod tax allocation requirements. Therefore, income taxes would no longer be allocated to continuing operations, discontinued operations, OCI items.
 - ii. Income taxes related to transactions with owners would be recognized in comprehensive income rather than as a direct charge or credit to equity.
- DP7. From a practical perspective, the Boards' preliminary view resolves the concerns associated with intraperiod tax allocation: it is arbitrary, complex, and does not provide much in the way of useful information. Members of both Boards generally agreed that the costs of allocating taxes exceed the benefits.
- DP8. The Boards are of the view that the notes to financial statements should include information to assist users in analyzing income tax information (such as information about tax rates) in lieu of intra-period tax allocation.

Income Taxes Currently Recognized in Equity (Transactions with Owners)

3. One of the consequences of the Boards' preference to present income taxes in a separate section is that **all** income taxes currently charged or credited directly to equity would be included in the statement of comprehensive income. However, adjustments to the opening balance of retained earnings for certain changes in accounting principles or changes in error (paragraph 36a of Statement 109) would continue to be

charged directly to equity as an adjustment to retained earnings. To help Board members understand the potential change in practice, the following paragraphs summarize the current guidance related to income taxes on transactions with owners in their capacity as owners.

4. Paragraph 36 of Statement 109 states that the income tax effects of the following items are to be charged or credited directly to equity:
 - a. Adjustments of the opening balance of retained earnings for certain changes in accounting principles or changes in error (as noted in paragraph 3 of this paper, this adjustment would continue)
 - b. Gains and losses included in comprehensive income, but excluded from net income
 - c. An increase or decrease in contributed capital
 - d. An increase in tax basis of assets acquired in a taxable business combination accounted for as a pooling of interests and for which a tax benefit is recognized at the date of the business combination
 - e. Expenses for employee stock options recognized differently for financial reporting and tax purposes
 - f. Dividends that are paid on unallocated shares held by an ESOP and that are charged to retained earnings
 - g. Deductible temporary differences and carry-forwards that existed at the date of a quasi-reorganization.

7. Presenting all income taxes in the statement of comprehensive income would result in a change in the **accounting** for income taxes related to transactions with owners and thus is beyond the stated scope of the financial statement presentation project. In September 2006, Board members were comfortable with going beyond presentation on this one issue.

Issues Raised by Board Members and Constituents

8. In the past few months, the staff has heard two main reasons why the Boards should reconsider their non-allocation view: (a) preparers are able to allocate income taxes using existing guidance, therefore “nothing is broken” and (b) net income is an important metric to both users and preparers.

Already Allocating Income Taxes

9. While at times allocating income taxes using the existing guidance is complex, an entity is able to do that allocation. The staff asserts that even though allocation is

“doable”, it does not necessarily result in useful information. While discussing the complexities of income taxes at the April 2005 joint meeting on short-term convergence, members of both Boards generally agreed that any income tax allocation will be arbitrary and asked the staff to explore eliminating intraperiod tax allocation, favoring a separate income tax category in the financial statements.

10. Any future discussion of income tax allocation (whether within the statement of comprehensive income or when allocating income taxes related to transactions with owners) will involve the complexities regarding tax allocation discussed in the past, compounded by the categories and sections introduced in this project. That is, not only might an entity have to allocate income taxes to discontinued operations and OCI items, but also to the operating, investing, and financing categories. The staff asserts that a revised allocation process would continue to be arbitrary and would most likely create similar anomalies to those found in Statement 109 and IAS 12.
11. However, a counterargument often made by some constituents is that even if allocation of income taxes is arbitrary, this information is better than the information an investor would have if they were to try to determine an after-tax amount. Moreover, less sophisticated users will not read past the primary financial statements and thus will not benefit from any new information provided in the notes (refer to Issue 2).
12. The input received from users has been mixed on this issue. However, as the Boards have yet to decide what additional information would be disclosed in the notes, the staff asserts that Board members should not put undue emphasis on the views expressed by users (or preparers) to date on this issue. That is, non-allocation of income taxes and the additional disclosure requirements should be considered as a package. In most recent conversations with users, even those who expressed a preference for allocating taxes to the various categories wanted the same additional information about income tax rates as those who supported non-allocation.

Need to Retain Net Income

13. Some Board members have shown an interest in retaining a *net income* subtotal in the statement of comprehensive income based on the input received by constituents; thus, some allocation of income taxes would be necessary.
14. The staff asserts that the inclusion of a *net income* subtotal is inconsistent with the Board’s preliminary view (long-term goal) that **all** *current* period changes in assets

View 1. They now think that income taxes are part of the underlying transaction and should be part of operating income, investing income, and so forth; or

View 2. They want to retain the *net income* subtotal for a transition period (until the Boards address individual OCI items).

17. Possible alternatives for the components to which an entity should allocate income taxes are as follows:

- a. **Alternative A.** Allocate all income tax effects to each category/section in the basic financial statements. As a result, every category/section would be calculated on an after-tax basis.
- b. **Alternative B.** Allocate income tax effects to selected categories, such as the *operating* category, and the *other comprehensive income* and *discontinued operations* sections. Allocation to those categories/sections would be similar to the allocation that is done under existing standards (allocation to the *operating* category would be instead of allocation to *continuing operations*).
- c. **Alternative C.** Allocate income tax effects to OCI items (or to the OCI section as a whole) and present the remaining income tax amount in the income tax section. (This would be a transitional alternative, only for the purpose of preserving a *net income* subtotal.)
- d. **Alternative D.** Present on a net-of-tax basis transactions for which the income tax effect can be objectively calculated (a discrete transaction). The remaining income tax expense/benefit for the period would be presented in the income tax section as a single, unallocated amount. Examples of discrete transactions that could be presented on a net-of-tax basis are a gain on the sale of real estate held for investment purposes or a gain on the sale of a business.

Staff Recommendation

24. The staff recommendation in the memorandum for this meeting was that the Boards should not revisit the issue of income tax presentation until they have received comments on their preliminary view regarding the presentation of income taxes and related note disclosures through the normal due process procedures.

8. As discussed at the March 5, 2008 Education Session, the staff is of the view that the Boards do not have a sufficient basis to affirm either the existing income tax allocation requirements or their preliminary view that the presentation of income taxes should change. However, there is a basis to discuss other ways of meeting user needs in this area.
5. Thus, the staff recommends that the discussion document include a neutral analysis of this issue, without expressing a preliminary view. As suggested in an addendum to the Board memorandum, the following views (and possibly others) could be included in the discussion document:
 - a. Taxes should not be allocated but rather replaced with disclosures
 - b. Taxes should be allocated between equity and comprehensive income
 - c. Taxes should be allocated between equity and some components of comprehensive income, such as:
 - i. Retaining current practice of allocating tax to continuing operations, discontinued operations, OCI and equity
 - ii. Expanding the items to which tax is allocated to also include business and financing sections within continuing operations, or
 - iii. Further expanding the items to which tax is allocated to include operating and investing categories within the business section
6. In addition, the notice for recipients could include a variety of questions, such as:
 - a. Should taxes be allocated? If not, are the proposed disclosures necessary or sufficient?
 - b. If taxes should be allocated, which categories should be presented net of tax? What would be the appropriate bases for those allocations?
 - c. Are the proposed disclosures also useful if income taxes continue to be allocated?
7. Finally, the Boards could provide illustrative examples of one or more of the views and related disclosures.

Questions for the Boards:

- 1a)** *Do Board members want to retain their preliminary view that income taxes should be presented in a separate section or present a neutral analysis of this in the document as summarized in paragraphs 5-7 above?*

ISSUE 2: ADDITIONAL INCOME TAX DISCLOSURES

25. If income taxes are not to be allocated in the statement of comprehensive income, the Boards' view is that an entity should disclose information in the notes to financial statements that will assist users in analyzing income tax information.
28. The users of financial statements that the staff sought input from on this issue had mixed views on whether or not income taxes should be allocated on the statement of comprehensive income and how taxes might be allocated. Those in favor of allocation typically cited the usefulness of net income as a starting point in analysis. Those that did not favor allocation generally felt that detailed disclosures related to the causes of tax anomalies would be more useful for analysis than arbitrary tax allocations that result in taxes attributable to operations as a "residual" amount.
33. Based on user input, the staff recommends the following disclosures that would be in addition to (or replace) the existing disclosures required by Statement 109 and IAS 12:
- a. An explanation of the relationship between income tax expense and comprehensive income in either or both of the following forms:
 - i. A numerical reconciliation between income tax expense and the product of comprehensive income multiplied by the statutory tax rate(s), and a numerical reconciliation between income tax expense and the current portion of income tax expense
 - ii. A numerical reconciliation between the effective income tax rate (income tax expense divided by pre-tax comprehensive income) and the statutory tax rate, and a numerical reconciliation between the effective income tax rate and the "current provision" effective tax rate (current portion of income tax expense divided by pre-tax comprehensive income).

In deciding what reconciling items to display in the reconciliation, line item descriptions should be consistent with other financial statements and an entity should not aggregate reconciling items if disaggregation would result in useful information for purposes of predicting future cash flows.

Statement 109 and IAS 12 currently provide an entity the choice of presenting the reconciliation using tax amounts or tax rates, which is why the recommendation above provides a choice. If the Boards prefer there not be a choice, the staff recommends the reconciliation be prepared using rates (as in (ii) above). An illustration of the recommended numerical reconciliation is on page 11 of this handout.

- b. A qualitative discussion about each significant reconciling item in the reconciliation in (a) above. The focus of the disclosure should be on the effect of tax rates in different jurisdictions, and on the transactions or events that influenced effective tax rates and how those factors may affect effective rates in the future. If a reconciling item relates to other comprehensive income, that relationship should be evident.
 - c. A qualitative discussion that explains the impact of income taxes on the operating, investing, financing, discontinued operations, and other comprehensive income categories/sections in the statement of comprehensive income, to the extent such information is not covered in (b) above. The focus of the disclosures should be on whether income taxes in each category differ from what a user would expect based on the entity's statutory tax rate. If major differences exist, the disclosure should provide information that allows a user to gauge whether each difference is likely to be maintained or reversed in future periods. If an entity disaggregates taxes by reportable segment for internal decision making, it would be encouraged to disclose each reportable segment's income tax expense or effective tax rate.
34. In addition to providing information to compensate for the elimination of intraperiod tax allocation, the recommended disclosures enhance the existing disclosure requirements. Entities that apply U.S. GAAP and IFRS are currently required to provide a quantitative schedule reconciling the [statutory/applicable] tax rates and the effective tax rates (or amounts) related to [income from continuing operations/accounting profit]. This reconciliation remains, except the reconciliation will be based on *pre-tax comprehensive income*.
35. The second part of the recommended numerical reconciliation (paragraph 33a) that reconciles the effective rate to the "current provision" rate is a new format for information currently provided elsewhere in the notes. Reconciling items in this portion of the schedule explain how changes in deferred tax assets and liabilities cause income tax expense to differ from the amount owed to (or refundable from) taxing authorities for the current period. U.S. GAAP and IFRS currently require entities to disclose the *balances* in deferred tax assets and liabilities by each major class of transaction. However, some of the changes in these balances will not affect income

tax expense for the year (for example, income tax assets or liabilities are recorded as part of a business combination), and thus the recommended reconciliation format should enhance the ability of users to analyze how deferred taxes affect effective tax rates. Distinguishing between the effective rates associated with deferred taxes and the current provision can be important for several reasons, not the least of which is that some temporary differences may take years to reverse, but the associated deferred taxes are not discounted for the time value of money.

36. The main change in the qualitative disclosure requirements is that the recommended disclosures should enhance the cohesion between the financial statements and notes. To this end, the qualitative discussion should help users understand if any significant tax savings or costs are coming from operating activities, investing activities, financing activities, discontinued operations, or items of other comprehensive income. Further, the focus is also on separately identifying tax effects that are likely to be transitory, with the goal of helping users to predict future effective tax rates.

Question for the Boards:

- 2a.)** *Do Board members agree with the recommended disclosures for purposes of the Discussion Paper/Preliminary Views document?*
- 2b.)** *If not, what should be modified?*

This illustration is presented for discussion purposes only and should be read only in the context of the meeting papers.

Reconciliation of taxes paid				
	2010		2009	
Tax expense at U.S. statutory rate	(51,572)	35.0%	(16,946)	35.0%
Tax expense at state statutory rate	(4,434)	3.0%	(1,457)	3.0%
Total U.S. Statutory tax	(56,007)	38.0%	(18,403)	38.0%
Taxes in other jurisdictions	728	-0.5%	422	-0.9%
Goodwill impairment			(20,592)	42.5%
Dividend income	16,470	-11.2%	15,250	-31.5%
Loss on Discontinued operations			10,000	-20.7%
<i>OCI items</i>				
AFS Securities	6936	-4.7%	6200	-12.8%
Provision for income taxes	(31,872)	21.6%	(7,123)	14.7%
Pension plan	(5,636)	3.8%	(5,200)	10.7%
Depreciation expense	24,098	-16.4%	23,625	-48.8%
Bad debt expense	(4,177)	2.8%	(3,263)	6.7%
Gain on disposal of PPE			(3,029)	6.3%
Loss on Discontinued operations			(7,500)	15.5%
<i>OCI items</i>				
Gain on revaluation of building	(6,625)	4.5%		
Unrealized gain on futures contract	842	-0.6%	780	-1.6%
Unrealized gain on AFS securities	(5,316)	3.6%	(4,700)	9.7%
Total Deferred tax	3,187	-2.2%	712	-1.5%
Current provisions for taxes	(28,685)	19.5%	(6,410)	13.2%

Events that are not taxed at the statutory rate

Different Tax Jurisdictions

The company's effective tax rate for 2010 (2009) was 21.6% (14.7%). This is lower than the combined U.S. Federal and Colorado statutory rates (35% + 4.6%) in part because of different tax rates in various jurisdictions.

- The company's operations in Ireland are subject to a 12.5% corporate income tax. This results in a reduction in the tax liability of \$0.9 million and \$0.5 million for years ending December 31, 2010 and December 31, 2009, respectively. Pretax earnings from Ireland increased 65% during 2010. While international expansion is still in preliminary stages, the company expects future operations to benefit from the favorable tax rates in Ireland.
- Our main operations in Colorado are subject to a flat 4.63% corporate income tax rate, while our limited operations in Montana are subject to a 6.75% state income tax. The result of this difference is an increased tax liability of \$0.2 million and \$0.1 million for years ending December 31, 2010 and December 31, 2009, respectively.
- During 2010, pretax earnings from the Montana office increased 37%. Despite higher corporate income taxes, Montana is a very attractive market for the company and we expect to continue increasing operations there.

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Other Differences from the Statutory Rate

Goodwill impairment losses are not deductible for tax purposes, resulting in a permanent difference between book and tax amounts, making the company's provision for income tax in 2009 \$21 million higher than expected based on the combined statutory rates. This goodwill impairment relates to Segment C only. We do not anticipate the need for further impairments, so this increase in our effective tax rate is not expected to continue.

Additional permanent differences arise because we own a noncontrolling portion of our subsidiaries. U.S. tax allows us to exclude 70% of our dividend income from taxable income. Dividends are also taxed at a lower rate (15%) than continuing operations. The combination of the two effects results in our provision for income taxes being \$17 million and \$15 million lower than expected based on statutory rates for years ending December 31, 2009 and December 31, 2010 respectively. We plan to maintain our investment in these subsidiaries, and therefore expect to continue enjoying similar tax benefits in the future as long as they can continue paying dividends. This dividend income is reported in the **investing category** of our statements of comprehensive income and cash flows.

In 2009, we reclassified certain assets as held for sale and remeasured them at fair value less cost to sell in accordance with SFAS 144. The resulting loss recognized in our financial statements in 2009 will be recognized as a capital loss for tax purposes when the assets are sold. A permanent difference results from different tax rates and a temporary difference results from different timing of the loss recognition. We do not expect future reclassification of assets and therefore do not anticipate similar tax impacts in future periods. Similarly, the gains on certain AFS securities will be taxed at a lower capital gains tax rate resulting in a permanent difference. It is the company's tax management policy to hold AFS securities long enough to qualify for capital gains tax and therefore we would expect future gains on AFS securities to receive similar tax treatment.

Temporary differences

As noted in the reconciliation schedule above, a variety of factors explain the difference between our provision for income taxes and the current portion of the income taxes provision. In each case, the difference is attributable to changes in deferred income tax assets or liabilities due to temporary differences between GAAP and the relevant tax laws.

- The tax savings related to bad debts will be realized in the near future due to the short-term nature of our receivables.

- The originating deferred tax amounts for pensions and depreciation exceed the reversing amounts in both 2009 and 2010, and the settlement of these amounts will occur in the distant future if our operations continue at the current level or grow larger. As required under SFAS 109, the deferred tax amounts have not been discounted to reflect the time value of money.
- The tax effects of the realized and unrealized gains are expected to be realized in the near future.
- The company has no immediate plans to sell our building and therefore expects the temporary difference due to remeasurement to reverse over the depreciable life of the asset.
- The temporary difference related to the loss on discontinued operations will be reversed when the assets are sold. The company expects to dispose of assets held for sale in the near future.

The following items are not expected to recur in future periods and therefore are not expected to affect the company's future effective tax rate: goodwill impairment, loss on discontinued operations, gain on disposal of PPE, and gain on revaluation of building.

As noted above and discussed in management's discussion and analysis/management commentary, the Company expects to increase operations in Montana and Ireland and therefore expects greater impact on the effective tax rate from these jurisdictions.

Our **operating activities** reflect a mixture of U.S., Colorado, Montana, and Irish tax rates. Colorado operations provided 95% (97%) of our operating income in 2010 (2009); in those same years Montana and Ireland provided 3% (2%) and 2% (1%), respectively. Should domestic or foreign legislators decide to change the statutory tax rate, remove the dividend exclusion, or alter other aspects of their income tax laws, our effective rates will change.

Because we issue all of our debt and buy short-term investments at the parent level, the combined U.S. and Colorado statutory rate is most relevant for assessing the tax implications of our **financing activities**.

Because we do not anticipate remitting the earnings from our Irish subsidiaries to the U.S. parent, we have not provided U.S. taxes on those earnings. If we were to remit the earnings, we would have to pay the difference between the United States and Irish statutory rates on those earnings.

Our **investing activities** are primarily in the United States; the tax rates are combinations of U.S. and Colorado statutory rates less the dividend exclusion.