February 2, 2018

Submitted via email: director@fasb.org
Technical Director
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 2018-210

Dear Technical Director:

The Technical Issues Group (TIG) of the Missouri Society of CPAs (MOCPA) appreciates the opportunity to respond to the Proposed Accounting Standards Update *Income Statement—Reporting Comprehensive Income (Topic 220).* The views expressed herein are written on behalf of the TIG of MOCPA. The TIG has been authorized by MOCPA's Board of Directors to submit comments on matters of interest to the society's membership.

We generally agree that the stranded tax effect associated with the change in the federal corporate income tax rate in the Tax Cuts and Jobs Act (TCJA) should be removed from accumulated other comprehensive income (AOCI), because to retain the stranded effect in AOCI would distort the equity and future period income of entities with significant amounts of stranded tax effect in AOCI. However, as discussed in our response to Question 1, we believe that it would be more understandable, useful, and accurate to accomplish the removal of the stranded tax effect by retrospectively adjusting AOCI through other comprehensive income (OCI) rather than as a reclassification directly between retained earnings and AOCI.

We also included in our response to Question 1 a recommendation to consider a practical expedient and a general discussion of how we interpreted the language of the standard in certain situations in the hopes that this would aid final deliberations about the specific language and scope of the Update.

Thank you for considering our comments. We would be pleased to respond to any questions the Board or its staff may have about the following comments. Please direct questions to Mark Winiarski, TIG Chairman, MWiniarski@CBIZ.com.

Sincerely,

Mark Winiarski, CPA
TIG Chairman

<u>Question 1:</u> Do you agree with the amendments in this proposed Update that would require a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the newly enacted federal corporate income tax rate? If not, why?

Response:

<u>Reclassification between retained earnings and AOCI vs backwards tracing</u>

We agree that the stranded tax effect in AOCI should be removed in order to provide financial statement users with more accurate and useful historical and future financial statements. If the stranded tax effect were retained without adjustment, the future earnings of companies with significant amounts of stranded tax effect would be distorted reducing the comparability, understandability, and usefulness of financial statements.

However, we believe requiring backwards tracing, where the adjustment is made through OCI, is a better method than the proposed method to accomplish the goal of eliminating the stranded effect related to the TCJA. We believe that backwards tracing provides a more useful historical (or current, if early adopted) presentation of after-tax earnings of companies and will be less confusing for financial statement users who may have difficulty understanding why a reclassification between AOCI and retained earnings was recorded in the 2017 financial statements, or how to interpret the reclassification, when comparing a company's financial statements from period to period or comparing multiple companies' financial statements to each other. In contrast, we believe financial statement users would generally understand a presentation that shows the effect of the TCJA in OCI, parallel to the TCJA's effect on net income.

In addition, we note that the Board's discussion and the exposure draft implicitly acknowledge that the existing prohibition on backwards tracing for AOCI is technically inferior to recognizing the effects of changes in tax rates in the respective categories of income. We agree with this conclusion. Historically the cost benefit of identifying and recognizing the stranded effects in AOCI and backwards tracing them through OCI may have been cost prohibitive due to the small amounts of changes in tax rates. It is clear that the scale of the change under the TCJA causes the benefits of backwards tracing to outweigh the costs. Because companies will have to compute the stranded tax effect under either the proposed Update or our preferred approach, we cannot identify any additional costs to be incurred in producing more accurate and useful financial statements utilizing backwards tracing through OCI.

In our consideration of the proposed reclassification between retained earnings and AOCI in contrast to backwards tracing through OCI, we considered the transition methods used in other recent accounting standards updates that impacted AOCI, such as Accounting Standard Update 2016-01 *Recognition and Measurement of Financial Assets and Financial Liabilities* (ASU 2016-01). In ASU 2016-01, the Board adopted a modified retrospective approach where the amount of the adjustment for items no longer recognizing through OCI would result in a reclassification between AOCI and retained earnings. We did not object to a modified transition approach for ASU 2016-01 because the standard was reclassifying the accounting for the entire class of investment and in effect changing the accounting principle applied to the investment prospectively. We see this circumstance as different because the accounting principle being changed is related to a portion of the accounting (changes in tax rates) for the amount recognized in AOCI. Unlike for items transitioned in ASU 2016-01, changes in this circumstance do not impact the prospective accounting for the changes in the asset or liability. Future changes in measurement of the assets and liabilities will continue to be recognized through OCI, except for other changes to the enacted tax rate, which we can only conclude would be highly unlikely to be significant in the near term.

Application of the proposed Update

We agreed with the decision to have the proposed Update address only the narrow-scope reporting issues arising as a consequence of the TCJA, with the intent of considering the need for a larger project, due to the immediate and significant financial reporting impact of the effect of the TCJA and the prohibition on backwards tracing in U.S. GAAP. However, we noted that by addressing the issue through a narrow-scope project, it may become complex for financial statement preparers to determine what effects should be identified and adjusted for and which ones remain prohibited. We identified the following questions or concerns and interpreted the proposed Update as described below:

- If a company initially recognized the income tax effect in OCI below the maximum previously enacted rate of 35 percent, what amount, if any, should be reclassified?

  We considered a company that initially recorded the income tax effect in OCI at a progressive rate less than 21 percent because of expectations that its future taxable income would not exceed $100,000 per year. We concluded that the progressive tax scale under prior tax law was the enacted rate and that the terms "difference," "initially charged or credited," and "remains in AOCI" used in the proposed Update would result in an increase in the amount of income tax effect retained in AOCI as a result of the increased enacted tax rate. For clarity, a company that recognized the tax effect initially at 10 percent would record a reclassifying adjustment between retained earnings and AOCI to increase the tax effect recorded in AOCI by an additional 11 percent under the proposed Update.

  We also considered a company that initially recognized income tax effect in OCI at a reduced rate because of an initial partial or full valuation allowance. In these situations, we concluded that the exclusion of valuation allowances charged previously to income from continuing operations does not prohibit reclassification as a result of changes as result of initial valuation allowances; however, the term "remains in AOCI" would result in a conclusion that no reclassification would occur between AOCI and retained earnings if there was initially a full valuation allowance because there would be no remaining amount of income tax effect at the enacted federal income tax rate in AOCI. For an initial partial valuation allowance, we concluded that under the proposed Update an entity should record a prorated adjustment between the previous and newly enacted rate based on the original percentage of the tax effect that had a valuation allowance applied under the previous enacted rate. This will add complexity to the computation of the adjustment, but we anticipate it would be uncommon.

- What should a company reclassify when the amount in AOCI relates to an outside basis difference of a controlled foreign corporation (CFC) for which the assertion of indefinite reinvestment did not apply?

  We considered in this circumstance that the deferred income tax item would be eliminated, and a one-time tax payable for the deemed repatriation tax would be recognized. Under the proposed Update, we believe the reference to deferred tax liabilities and assets would require the reclassification in this instance to be the difference between the amount initially recognized in OCI for tax effect and zero, resulting in a full reversal of the initial tax effect recognized in OCI. We considered whether this was the best approach, or if a reclassification based on the amount of one-time deemed mandatory repatriation tax was more appropriate. We concluded that we did not object to the limitation on the reclassification to the effect of remeasuring deferred tax liabilities and assets. If the scope of this project were broader and designed to address similar circumstances that may arise in the future, we would encourage additional research and consideration of the best method to address these issues.

- How should stranded amounts from indirect effects of TCJA be accounted for in AOCI, such as state income tax changes made in conformity with the switch to a territorial tax system and changes in effective tax rates as a result of state income tax deductibility for federal income tax purposes?

  We considered the language of the proposed Update noting that it explicitly addresses the U.S. federal corporate income tax rate and believe this language excludes indirect effects. We believe that the indirect effects in general would not be significant enough to warrant a short-term narrow fix given the likely cost to track and measure the differences compared to the limited benefit that would likely be achieved. Therefore, we support the proposed Update as applicable to the U.S. federal corporate income tax rate. However, we would not be opposed to the introduction of a policy choice to reclassify the indirect effects of the TCJA so that companies could reclassify these effects based on the significance to their financial statements. We do not think that permitting such limited optionality would reduce the comparability of financial statements, because of our belief that in most situations the indirect effects are insignificant.

- What if a company has a long running AOCI item, such as foreign currency adjustments, for which historical information about the initial tax effect recognized through OCI is not known or would be prohibitively expensive to obtain?

> We could imagine a situation where the rate that was recognized through OCI fluctuated over time, and the amount currently in AOCI is only kept on a net of tax basis; perhaps in this situation, it would only be possible to measure the reclassification required by the proposed Update by reconstructing multiple years of activity. We are concerned that this is more likely to occur with U.S. GAAP financial statements because the previous prohibition on backwards tracing would have allowed companies to choose to not track or maintain records of the year to year tax effect recognized in OCI in a format that would be easy to obtain and analyze for purposes of applying the proposed Update. Although we suspect that the information necessary may be obtainable from the deferred tax item, we were not able to conclude that this would always be the case.
>
> We encourage the Board to consider adding a practical expedient when it is impractical to obtain the information to measure the reclassification of the amount between AOCI and retained earnings for tax effects recognized in OCI earlier than a specified point in time (i.e. such as in periods beginning before December 15, 2014). Companies applying the practical expedient would then make disclosures about the use of the practical expedient, why it was impractical to obtain the information, the last date for which it was practical to obtain the information, and that no amounts related to the tax effect were reclassified for amounts recognized in OCI earlier than the last date for which it was practical to obtain the information. We believe that such a practical expedient would be consistent with other instances where the benefits of obtaining information are outweighed by the costs, such as for the measurement of equity securities without a readily determinable fair value in ASU 2016-01 and for the variable interest entity model for legal entities created prior to December 31, 2003, in ASC Topic 810 *Consolidations.*

We also considered whether optionality should be permitted in the proposed Update. We noted there were significant advantages to permitting companies to make independent evaluations of the cost-benefit of measuring the amount of the reclassification that should be made, including but not limited to allowing companies to deal with the above potential issues in the way that best suits their circumstances, but ultimately concluded that the proposed mandatory solution was better than permitting optionality in order to maintain comparability of financial statements and the integrity of future statements of earnings. We believe that financial statement users' evaluations of financial statements that include the effects of the TCJA will already be challenging enough without additional optionality for the handling of a significant effect of the TCJA. We also believe a company that had an immaterial amount to be reclassified could conclude that it need not measure and reclassify the amount in the proposed Update based on materiality. Although a materiality approach would not be ideal because of the reporting and tracking that would likely be necessary under audit, it would permit companies with insignificant amounts of AOCI to avoid much of the burden of the proposed Update.

<u>Question 2:</u> Are the transition requirements appropriate? If not, what transition approach is more appropriate and why?

Response: We agree with the proposed transition requirements. We believe a full retrospective method is appropriate. We note that the proposal to reclassify the stranded effect between AOCI and retained earnings is the equivalent of applying a modified retrospective approach to an accounting principle permitting backwards tracing through OCI for the TCJA.

We believe a full retrospective approach would be appropriate if our preferred method of backwards tracing through OCI were adopted.

<u>Question 3:</u> Do you agree that early adoption should be permitted?

Response: We agree with permitting early adoption as described in the proposed Update.

<u>Question 4:</u> Do you agree with the proposed effective date? If not, what effective date is more appropriate and why?

Response: We agree with the proposed effective date.

<u>Question 5:</u> GAAP generally prohibits *backwards tracing,* which is the process of recognizing the effects of changes in deferred tax amounts in the current year in the same line item in which the deferred tax amounts were originally recognized (for example, other comprehensive income) in prior years. The Board did not allow backwards tracing as part of this project and is currently researching the merits of a broader project on backwards tracing. Should the Board add a broader project on backwards tracing to its active agenda? If so, why? Additionally, should the following alternatives to backwards tracing be considered in that broader project? If so, why?

Response: The TCJA highlighted an issue in GAAP related to backwards tracing that was previously not considered to be significant because of the infrequent and insignificant changes in enacted tax rates. We believe that the proposed Update demonstrates that the prohibition on backwards tracing leads to less useful financial statements than if backwards tracing were permitted for OCI. A project on backwards tracing is warranted because of the deficiency in GAAP that does not exist in IFRS. We recommend the Board address the deficiency now that it has been made obvious. However, due to the infrequency of changes to enacted tax rates we believe this project is of lower priority than the projects that were identified by the Board through its outreach during 2017.

a. Accounting for the release of the stranded tax effects from accumulated other comprehensive income

Response: We believe full backwards tracing through OCI is the most appropriate and useful method for preparing financial statements when a change in tax rate is enacted.

b. Reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects associated with *prior changes* in other tax rates (for example, state and local taxes)

   Response: We believe the reclassification of prior stranded tax effects should be considered, but we would likely conclude that the cost-benefit does not justify requiring the reclassification.

c. Reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects associated with all *future changes* in tax rates.

   Response: We believe that a reclassification between AOCI and retained earnings without recognizing the effect in income tax expense or OCI would be inappropriate for future changes in tax rates because it distorts after-tax earnings and OCI in the period of enactment.