



Ernst & Young LLP
5 Times Square
New York, NY 10036

Tel: +1 212 773 3000
ey.com

Ms. Susan M. Cospers
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

2 February 2018

Proposed Accounting Standards Update, *Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income* (File Reference No. 2018-210)

Dear Ms. Cospers:

We appreciate the opportunity to comment on the proposed Accounting Standards Update (ASU) issued by the Financial Accounting Standards Board (FASB or Board). We support the Board's responsiveness to the concerns raised by stakeholders regarding the effects of US tax reform¹ on financial reporting and concur that the proposed reclassification of certain tax effects from accumulated other comprehensive income to retained earnings would eliminate the stranded tax effects resulting from the Tax Cuts and Jobs Act.

However, we question whether the proposed guidance would be beneficial or operational for all entities. Therefore, we recommend that the Board give companies the option to apply the guidance and/or exclude certain tax effects recorded in other comprehensive income (OCI) from the scope of any final standard.

We continue to believe that the general prohibition against backwards tracing results in illogical accounting and that the concerns raised by stakeholders highlight why the FASB, separate and apart from this project, should revisit the prohibition on backwards tracing. We believe it is counterintuitive to record the tax effects of transactions in OCI but record a change in those tax effects (e.g., due to a change in tax law or a change in valuation allowance) as a component of income from continuing operations. We believe this is why the FASB needs to undertake a review of backwards tracing and determine whether the practical and systems limitations that contributed to crafting the prohibition are still present.

* * * * *

¹ H.R.1 – An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, which is known as the Tax Cuts and Jobs Act.



Our responses to the questions in the proposed ASU are included in Appendix A.

We would be pleased to discuss our comments with the Board or its staff at your convenience.

Very truly yours,

Ernst & Young LLP

Appendix A – Responses to questions in the proposal

Question 1: 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?

We support the proposed amendments that would allow entities to reclassify the stranded tax effects resulting from the newly enacted federal corporate income tax rate from accumulated OCI to retained earnings and believe the Board's proposal may alleviate the negative effects that result from the prohibition on backwards tracing for some companies.

We understand that the Board developed the proposed amendments in response to concerns raised by some preparers and industry groups (e.g., banks, insurers) about the tax effects that will be stranded in OCI when deferred tax balances related to unrealized gains and losses from available-for-sale (AFS) securities are remeasured at the new lower corporate tax rate. We are concerned that some preparers may face operational challenges in implementing what is designed to address concerns that are more relevant to certain specific industries. Therefore, we recommend that the FASB give companies the option to apply the final guidance. In addition, we question whether requiring its application to other items accounted for in OCI (e.g., cumulative translation adjustments, hedging items, employee benefits) is necessary or should instead be optional. We recommend that the FASB consider providing an option to apply the guidance to those items specifically raised by preparers, such as tax effects related to AFS securities, thereby excluding certain items recorded in OCI that may be challenging for some companies to identify and record.

In certain cases, the change in tax law results in a change in deferred tax effects, as well as a remeasurement of those effects. We recommend the FASB provide guidance to address the ordering in these cases. For example, if a company had previously provided deferred taxes on its foreign currency translation adjustments related to foreign earnings that were not indefinitely reinvested, these earnings are now subject to the one-time transition tax at a tax rate other than the 21% statutory rate (or in some cases may not be taxable). Based on the guidance in proposed paragraph 220-10-45-12A, it is unclear what amount should be reclassified from accumulated OCI to retained earnings. In addition, other provisions in the new tax law could also affect the measurement of deferred taxes associated with the cumulative translation adjustment and it is unclear how those provisions should factor into the determination of the reclassification adjustment.

Further, we recommend that the FASB consider amending the guidance in proposed paragraph 220-10-45-12A to clarify whether a company should consider the related effects of changes to valuation allowances. As proposed, the guidance is not clear on how the remeasurement of valuation allowances is considered in determining the amounts to reclassify to retained earnings. For example, if a company had a full valuation allowance against its deferred tax assets (both of which were originally recorded through OCI) on the date of enactment, it would have recorded both a remeasurement adjustment to its deferred tax asset and an offsetting adjustment to its valuation allowance to reflect the lower corporate tax rate. If the valuation allowance was established in a period subsequent to the initial recording of the deferred tax assets, then stranded amounts exist in accumulated OCI. However, if the valuation allowance was established at initial recognition, no stranded amounts remain in accumulated OCI. For valuation allowances that were established many years ago, companies may find it challenging to determine the amounts that remain in accumulated OCI.

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

We understand that entities may prefer to reclassify stranded tax effects in the same period they recognize the effects of tax reform (i.e., in the period of enactment), and we support the conceptual principle of matching these items.

We also support the application of the transition requirements across multiple periods to allow for the adjustment of stranded tax effects to align with the related adjustments to enactment date provisional amounts that a company may record in subsequent periods. That is, we would expect any adjustment of a provisional amount that affects amounts in OCI to have a corresponding adjustment to reclassify any residual stranded tax effects during the measurement period provided by Securities and Exchange Commission Staff Accounting Bulletin (SAB) 118. This means that an adjustment in an interim period in 2018 may result in a partial effect through the income statement (change in provisional amount), and a partial effect through the balance sheet (reclassification adjustment) in that period.

We believe companies that do not early adopt the standard may find the transition adjustments more challenging than companies that adopt the standard in a period soon after the enactment date of tax reform. For example, a calendar year-end company that adopts the proposed ASU in 2019 would be required to revise 2017 (and possibly 2018 financial statements, including interim periods within 2018) to account for the effects of adoption, based on the proposed transition requirements. Accounting for events that take place during the retrospective period, such as adoption of certain accounting standards (e.g., ASU 2016-01), a change in indefinite reinvestment assertion or reclassification of amounts from OCI that existed at the enactment date, may make the retrospective adjustments more complex because companies may be required to recast prior periods for differences that would have arisen in subsequent accounting if the enactment date accounting adjustment were altered. We recommend the FASB consider these scenarios when finalizing the transition provisions.

Question 3: Do you agree that early adoption should be permitted?

We believe that early adoption should be permitted. Given the urgency with which the issue was raised to the Board, it is clear that certain entities believe their financial statements would provide more useful information to users if the proposed ASU were adopted as soon as possible. Early adoption may also help other entities avoid some of the operational issues described in Question 2.

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

We agree with the proposal to align the effective date with the closing of the measurement period provided for by SAB 118 so that entities may finalize their accounting for the effects of tax reform before making the reclassification adjustments. Unless the Board intended otherwise, we recommend that the FASB include explicit language in any final guidance indicating that the guidance should not be applied by analogy to other tax law changes in the future.

Question 5: 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?

- a. Accounting for the release of the stranded tax effects from AOCI
- b. Reclassification from AOCI to RE for stranded tax effects associated with prior changes in other tax rates (e.g., state and local taxes)
- c. Reclassification from AOCI to RE for stranded tax effects associated with all future changes in tax rates

We support the addition of a broader project on backwards tracing to the Board's standard-setting agenda. While we understand the challenges raised in previous standard-setting efforts on this issue, we continue to believe that the prohibition on backwards tracing results in illogical accounting. We believe it is counterintuitive to initially record the tax effects of a transaction in OCI but record a change in those tax effects (e.g., based on a change in tax law or a change in valuation allowance) as a component of income from continuing operations. The concerns raised by stakeholders regarding stranded amounts due to tax reform highlight why this prohibition should be revisited.

We intend to follow up with the staff with additional suggestions on how to pursue this project.