FINANCIAL ACCOUNTING STANDARDS BOARD

Board Meeting Handout

Disclosure Framework—Income Taxes

January 25, 2017

PURPOSE OF THIS MEETING

1. The purpose of this meeting is to provide a summary of comments from the 47 letters received in response to the proposed Accounting Standards Update, *Income Taxes (Topic 740): Disclosure Framework—Changes to the Disclosure Requirements for Income Taxes*, which was published for comment on July 26, 2016.

2. This handout is organized as follows:

   (a) Background information

   (b) Comment letter demographics

   (c) Summary of comments received.

BACKGROUND INFORMATION

3. The Board issued the amendments in the proposed Update on Topic 740 as part of the disclosure framework project. The objective and primary focus of the project are to improve the effectiveness of disclosures in the notes to financial statements by facilitating clear communication of the information required by generally accepted accounting principles (GAAP) that is most important to users of each entity's financial statements. In March 2014, the Board issued a proposed FASB Concepts Statement, *Conceptual Framework for Financial Reporting—Chapter 8: Notes to Financial Statements*, which is intended to identify a broad range of possible information for the Board to consider when deciding on the disclosure requirements for a particular Topic. From that intentionally broad set, the Board would identify a more narrow set of disclosures about that Topic to be required on the basis of an evaluation of whether the benefits of entities providing the information outweigh the

perceived costs. The Board decided to test the guidance in the proposed Concepts Statement and improve the effectiveness of disclosure requirements on inventory, income taxes, fair value measurements, and defined benefit pensions and other postretirement plans by using those proposed concepts. The amendments in the proposed Update on Topic 740 are the result of the Board's consideration of the concepts in the proposed Concepts Statement as they relate to income tax disclosures.

4. In September 2015, the Board issued the proposed Accounting Standards Update, *Notes to Financial Statements (Topic 235): Assessing Whether Disclosures Are Material*, which would promote a reporting entity's use of discretion when evaluating disclosure requirements set forth by the Board. Appropriate application of the amendments in the proposed Update on Topic 235 would result in an entity providing material information while also excluding immaterial information. Those proposed amendments also would, among other things, clarify that a reporting entity may consider materiality when assessing disclosure requirements for both quantitative and qualitative information. The amendments in the proposed Update on Topic 235 have been considered by the Board in developing the amendments in the proposed Update on Topic 740. That is, the amendments in the proposed Update on Topic 740 would:

   (a) State that an entity need not provide required disclosures if they are immaterial

   (b) Eliminate phrases such as "an entity shall disclose at a minimum," which make it difficult to justify omitting immaterial disclosures

   (c) Refer readers to Topic 235 (as would be amended by the guidance in the proposed Update on Topic 235) for discussion of the appropriate exercise of discretion. While referenced in the proposed Update on Topic 740, the amendments in the proposed Update on Topic 235 remain subject to redeliberations as of the date of the writing of this handout.

5. The amendments in the proposed Update on Topic 235 include language designed to promote an entity's use of discretion that reinforces that the entity can assess disclosures on the basis of whether they are material, thereby improving the effectiveness of the notes to financial statements.

6. The amendments in the proposed Update on Topic 235 would add guidance such as "an entity shall provide required disclosures if they are material" to each *FASB Accounting Standards Codification*® Topic. A couple of comment letter respondents to the amendments in the proposed Update on Topic 235 stated that this wording may cause preparers to have to prove that a disclosure is material to include it in the financial statements. To respond to those comments, the Board included different wording in the proposed Update on Topic 740. The amendments in the proposed Update on Topic 740 state that "an entity need not provide disclosures if they are immaterial" (as noted above in paragraph 4(a)). The Board discussed the amendments in the proposed Update on Topic 235 at the December 14, 2016 Board meeting, and Board members stated that they never intended for the original wording from the proposed Update on Topic 235 to place this "burden of proof" on preparers. At the December 14, 2016 Board meeting, Board members stated that they intended to align all the definitions of *materiality* used in the financial reporting environment by referencing the Supreme Court's definition. Comments on the amendments in the proposed Update on Topic 740 that refer to *materiality* are discussed in paragraphs 75–78 of this handout.

7. The amendments in the proposed Update on Topic 740 also would:

   (a) Replace the term *public entity* that is currently in Topic 740 with the term *public business entity*, which is defined in the Master Glossary of the Codification.

   (b) Require the following additional disclosure requirements for all entities on the basis of the proposed Concepts Statement:

      (i) Description of an enacted change in tax law that is probable to have an effect on the reporting entity in a future period.

      (ii) The following information disaggregated between domestic and foreign:

         (1) Income (or loss) from continuing operations before income tax expense (or benefit) (pretax income [loss]).

         (2) Income tax expense (or benefit) from continuing operations.

(3) Income taxes paid.

(iii) The amount of income taxes paid to any country that is significant to total income taxes paid.

(iv) An explanation of circumstances that caused a change in assertion about the indefinite reinvestment of undistributed foreign earnings and the corresponding amount of those earnings.

(v) The aggregate of cash, cash equivalents, and marketable securities held by foreign subsidiaries.

(vi) The description of a legally enforceable agreement with a government that reduces, or may reduce, an entity's income tax burden.

(c) Eliminate the requirement for all entities to (i) disclose the nature and estimate of the range of the reasonably possible change in the unrecognized tax benefits balance in the next 12 months or (ii) make a statement that an estimate of the range cannot be made on the basis of the proposed Concepts Statement, which limits future-oriented information.

(d) Require the following additional disclosure requirements for all public business entities on the basis of the proposed Concepts Statement:

(i) Within the reconciliation of the total amounts of unrecognized tax benefits at the beginning and end of the period, settlements using existing deferred tax assets separate from those that have been or will be settled in cash.

(ii) The line items in the statement of financial position in which the unrecognized tax benefits are presented and the related amounts of such unrecognized tax benefits. If the unrecognized tax benefits are not presented in the statement of financial position, those amounts should be disclosed separately.

(iii) The amount and explanation of the valuation allowance recognized and/or released during the reporting period.

(iv) The total amount of unrecognized tax benefits that offsets the deferred tax assets for carryforwards.

(e) Modify the existing rate reconciliation requirement for public business entities to be consistent with U.S. Securities and Exchange Commission (SEC) Regulation S-X 210.4-08(h), *Rules of General Application—General Notes to Financial Statements: Income Tax Expense*. That regulation requires separate disclosure for any reconciling item that amounts to more than 5 percent of the amount computed by multiplying the income before tax by the applicable statutory federal income tax rate. The proposed amendments would further modify the requirements to explain the changes in those reconciling items from year to year.

(f) Reduce diversity in practice by explicitly requiring a public business entity to:

(i) Disclose the amounts of federal, state, and foreign carryforwards (no tax effect) by time period of expiration for each of the first five years after the reporting date and a total amount for any remaining years.

(ii) Disclose the deferred tax assets for federal, state, and foreign carryforwards (tax effect) before valuation allowance. Those amounts would be further disaggregated by time period of expiration for each of the first five years after the reporting date and a total amount for any remaining years.

(g) Reduce diversity in practice by explicitly requiring an entity other than a public business entity to disclose the amounts of federal, state, and foreign carryforwards (no tax effect) and their expiration dates.

8. The comment period for the proposed Update on Topic 740 ended on September 30, 2016.

COMMENT LETTER DEMOGRAPHICS

9. The 47 respondents to the proposed Update on Topic 740 are summarized by type as follows:

Respondent Type	
Academic	1
Association Group	17
Auditor	10
Preparer	14
User*	3
Other	2
Total:	47

* Two accounting analysts and one investor association

10. The association group is further broken down as follows:

Respondent Type	
Accounting Society	3
Preparer Association	6
Public Interest Group	2
State Society of CPAs	4
Tax Research Organization	1
Trade Union Federation	1
Total:	17

11. The preparers and preparer associations are further broken down by industry in the chart below. All preparer respondents are public companies:

Industry	
Financial Services	6
Insurance	2
Technology	2
Health Care	1
Energy	3
Pharmaceuticals	3
Manufacturing	1
Executive Associations	2
Total:	20

12. Unless otherwise stated, the statistics in this handout are calculated on the basis of 47 respondents. In this handout, the staff uses statistical analyses to summarize the feedback. However, it is important to note that the Board bases its decisions on the quality and persuasiveness of stakeholders' reasoning, not on the number of stakeholders that support a particular view or position.

SUMMARY OF COMMENTS RECEIVED

13. Two-fifths of respondents agreed and two-fifths conditionally agreed that the amendments in the proposed Update on Topic 740 would result in more effective, decision-useful information about income taxes. The remaining one-fifth of respondents opposed the amendments in the proposed Update. Conditional agreement was most commonly caused by concerns with one or more of the proposed disclosure requirements. Of the respondents that opposed or conditionally agreed with the amendments in the proposed Update, about half of them had concerns about the disclosure of cash, cash equivalents, and marketable securities held by foreign subsidiaries and the remainder had concerns about the disclosures of disaggregating income taxes paid and government assistance. Respondents' concerns on the amendments in the proposed Update are discussed in paragraphs 15–70 of this handout.

14. This section summarizes feedback as follows:

    (a) Indefinitely reinvested foreign earnings

    (b) Disaggregation of income tax information

    (c) Government assistance

    (d) Change in tax law

    (e) Carryforwards

    (f) Unrecognized tax benefits

    (g) Rate reconciliation

    (h) Valuation allowance

    (i) Transition, implementation, and adoption

    (j) Materiality.

Indefinitely Reinvested Foreign Earnings

15. There were 39 comment letters that addressed indefinitely reinvested foreign earnings disclosures. The proposed Update includes two amendments specifically related to indefinitely reinvested foreign earnings. They are:

    (a) An explanation of circumstances that caused a change in assertion about the indefinite reinvestment of undistributed foreign earnings and the corresponding amount of those earnings

    (b) The aggregate of cash, cash equivalents, and marketable securities held by foreign subsidiaries.

    Comments related to the proposed disclosures are discussed in paragraphs 19–27 of this handout.

16. Question 5 in the proposed Update asked respondents about the amendments in paragraph 15 above and whether there is other information that the Board should consider about those potential disclosures as well as whether there are other disclosures about indefinitely reinvested foreign earnings that would be more cost

beneficial. There were 16 respondents that stated that there are no other disclosures or information relating to indefinitely reinvested foreign earnings that the Board should consider.

17. Current GAAP requires the disclosure of the amount of the unrecognized deferred tax liability for the temporary difference related to the earnings that are indefinitely reinvested or a statement that the determination is not practicable. There were 10 respondents that commented on this current disclosure requirement. Eight respondents, including all three user respondents, stated that the practicability exception should be removed because it would require entities to provide the potential tax liability on indefinitely reinvested foreign earnings. One user (investor association) indicated:

> The key problem facing users of financial statements is the fact that they cannot determine the full potential tax exposure that permanently reinvested earnings may face if they were subject to some form of repatriation. Given that many companies indicate having significant amounts of permanently reinvested earnings, the tax risk facing these earnings could be significant as well. [CL #26]

One accounting society and one preparer stated that the practicability exception should remain because the uncertainty about timing, legal restrictions, and tax rate fluctuations makes determination of the liability too complex.

18. One auditor and another accounting society suggested that entities that utilize the practicability exception disclose an explanation about why the calculation of the unrecognized deferred tax liability is not practicable. Another auditor and the accounting society favored a disclosure of an estimated liability using simplified assumptions based on the assumption that the entire amount of the indefinitely reinvested earnings would reverse as of the reporting date and in the most tax-efficient manner. One trade union federation favored a disclosure of a rough estimate or range of estimates of the liability rather than nothing.

Change in Assertion

19. The amendments in the proposed Update include a requirement to disclose an explanation of circumstances that caused a change in assertion about the indefinite

reinvestment of undistributed foreign earnings and the corresponding amount of those earnings. There were 13 respondents that commented on this proposed disclosure. Half of those respondents supported the proposed disclosure, a little under half conditionally agreed with the proposed disclosure, and the remaining respondents opposed the proposed disclosure. Some of those that conditionally agreed with the proposed disclosure cited confidentiality concerns. They noted that negative consequences may arise from disclosing confidential plans that lead to the change in assertion (for example, a change in assertion can be due to a need to repatriate foreign earnings in anticipation of an acquisition that has not yet been publicly announced). Two preparers/preparer associations opposed the proposed disclosure for this same reason.

20. Other comments received on the proposed disclosure included the following:

(a) One user (accounting analyst) that conditionally agreed with the proposed amendment stated that the Board should require entities to explain how the change in assertion about undistributed foreign earnings factors into current or ongoing assertions. The user stated that "companies should be required to provide an explanation as to how repatriation actions have a bearing on management's declared intention to permanently reinvest earnings, and if not, why not" (CL #27).

(b) One user (investor association) that conditionally agreed with the proposed amendment stated that entities should disclose a qualitative discussion of the tax consequences of remitting foreign earnings and the sustainability of their tax position.

(c) One academic that conditionally agreed with the proposed amendment suggested a disclosure, in the period in which the earnings are initially asserted to be reinvested, of how foreign earnings would be reinvested to provide users with a basis for evaluating management's previous representations when the assertion is changed.

(d) One user (accounting analyst) and one accounting society that conditionally agreed with the proposed amendment said that entities should disclose indefinitely reinvested earnings by jurisdiction or significant jurisdiction. The user stated:

> As governments more aggressively seek taxes of companies whose strategies they challenge, it becomes more important for investors to know which countries a firm has operations so they can assess the sustainability and risks involved in the assumptions of indefinitely reinvested foreign earnings. [CL #41]

(e) Another user (investor association) that conditionally agreed with the proposed amendment said that entities should disclose a country-by-country breakdown of material indefinitely reinvested foreign earnings for countries in which these earnings are still held in cash.

Cash, Cash Equivalents, and Marketable Securities Held by Foreign Subsidiaries

21. The amendments in the proposed Update include a requirement to disclose the aggregate of cash, cash equivalents, and marketable securities held by foreign subsidiaries. There were 29 respondents that commented on this proposed disclosure. Three-fifths of those respondents, including all preparers, opposed the proposed disclosure, one-fourth of the respondents conditionally agreed with the proposed disclosure, and the remainder supported the proposed disclosure.

22. Eight preparers/preparer associations, five auditors, and one state society said that users could assume that the liquid assets are available for repatriation, while they may not be available because of restrictions, limitations, or other plans for those funds. Those respondents had the following comments:

    (a) Two auditors and a state society that conditionally agreed with the proposed amendment said that for the disclosure to be more decision useful and less misleading, entities also should disclose the limitations or restrictions on their cash, cash equivalents, and marketable securities or exclude those amounts from the disclosure. One preparer opposed the proposed amendment and listed this as one of its reasons (additional comments from this preparer are in (d) below).

    (b) Three auditors and one preparer association that conditionally agreed with the proposed amendment said that the information is misleading because there is no indication of whether or how the disclosed amount is related to indefinitely reinvested earnings. Two preparers/preparer associations opposed the proposed amendment and listed this as one of their reasons.

(c) Three preparers/preparer associations that opposed the proposed amendment noted that decisions relating to undistributed foreign earnings are based on many complex factors. They said that while large amounts of cash, cash equivalents, and marketable securities held by foreign subsidiaries may be an indication of an entity's ability to repatriate undistributed foreign earnings, an entity can ultimately determine to indefinitely reinvest those earnings. As a result, the disclosure could potentially lead a user to incorrect assumptions about the amount and timing of earnings to be repatriated.

(d) One preparer said that it would most likely need to supplement the proposed disclosure with voluntary disclosures of its liquid assets available for repatriation. However, reliably determining the amounts available for repatriation, or associated with indefinitely reinvested foreign earnings, would be costly and require significant judgment. The preparer requested an exemption for "companies with foreign operations whose business model involves significant investments in marketable securities, and are subject to minimum capital requirements" (CL #22) because the additional complexity and costs would not be justified by the perceived benefits.

23. Three preparers/preparer associations that opposed the proposed amendment noted that liquid asset balances of financial institutions vary significantly day to day, making the proposed disclosure not decision useful. One of those preparers suggested an exemption for regulated financial services companies. Another preparer association that conditionally agreed with the proposed amendment for other clarification reasons had a similar comment.

24. A user (accounting analyst), an accounting society, and one preparer association that opposed the proposed amendment stated that there is not necessarily a correlation between the proposed disclosure and amount of taxes that would be due upon repatriation of the foreign earnings. The preparer association said that "if the purpose

of this disclosure is to allow users to use this information to project tax effects of a future repatriation, this information can be misleading" (CL #13). Two auditors that conditionally agreed with the proposed amendment said that the requirement could be misleading without information about tax consequences.

25. Nine respondents requested that the Board clarify the definitions of *domestic* and *foreign* and the definition of a *foreign subsidiary*. Respondents' requests for clarification covered the proposed disclosures on cash, cash equivalents, and marketable securities; pretax income (loss); income tax expense (or benefit); and rate reconciliation.

26. Four preparers/preparer associations and one auditor said that the definition of *foreign subsidiary* is ambiguous. They asked if foreign subsidiary is limited to controlled foreign operations or if it includes one or more of the following entities:

    (a) Foreign branches of domestic entities

    (b) Disregarded entities that are included in the U.S. federal income tax return (not recognized for tax purposes as separate from their parent entity)

    (c) Separate legal entities classified for U.S. tax purposes as non-U.S. partnerships or non-U.S. corporations.

27. Three auditors and three preparers/preparer associations requested that the Board provide guidance on or define *marketable securities*.

Disaggregation of Income Tax Information

28. There were 34 respondents that commented on one or all of the proposed requirements to (a) disaggregate pretax income (loss) and income tax expense (or benefit) between domestic and foreign and (b) disaggregate income taxes paid between domestic and foreign and by significant country. Those comments are addressed in paragraphs 33–39 of this handout.

29. Question 4 in the proposed Update asked respondents if there are costs or benefits (other than those in paragraph BC22 of the proposed Update) regarding the potential disclosures on pretax income (loss), income tax expense (or benefit), and income

taxes paid or any additional country-level disclosures that the Board should consider. There were 12 respondents that stated that additional country-level disclosures should not be required. There were 15 additional respondents that commented on country-by-country reporting of financial information. Their comments are summarized in paragraphs 30–32 of this handout.

30. Seven respondents said that entities should be required to disclose pretax income for countries that either have significant pretax income or significant income taxes paid. One tax research organization stated that without requiring both the pretax income and income taxes paid, the disclosures would "exclude precisely those countries where the company is paying an insignificant amount in taxes because they are shifting profits to low- or no-tax jurisdictions" (CL #26). One preparer stated that the disclosure of taxes paid by a significant country is out of context without disclosing revenues, expenses, tax rates, and other income tax information for the country. The preparer also indicated that disclosing the additional information might cause competitive harm.

31. Two users (accounting analysts), one tax research organization, one trade union federation, one auditor, and one other respondent requested that the Board require country-by-country reporting of key financial information such as pretax income (loss), income tax expense, revenues, etc. Four of those respondents commented that this would result in no added cost for entities because the information is already required under the final U.S. Treasury regulation (although the information is not required to be made public). One respondent stated that improvements in the amendments in the proposed Update are undermined by not requiring further country-by-country disclosures.

32. An auditor noted that it would be costly to require country-by-country reporting because:

    (a) Entities with annual revenue below $850 million are not subject to the final regulation by the U.S. Treasury and, therefore, would incur substantial costs.

    (b) U.S. entities have until the fifteenth day of the eighth month of the following year to submit their information to the Internal Revenue Service and up to 12 months in some foreign jurisdictions. Financial reporting deadlines are significantly earlier.

(c) Country-by-country reporting is not compiled using the same controls as that of financial reporting.

(d) The country-by-country information is useful to taxing authorities to perform high-level transfer pricing risk assessments rather than for assessing tax exposures of individual entities.

Pretax Income (Loss) and Income Tax Expense (or Benefit)

33. The amendments in the proposed Update include a requirement for entities to disclose pretax income (loss) and income tax expense (or benefit) disaggregated between domestic and foreign. This proposed disclosure is currently a SEC requirement. There were 25 respondents that commented on the proposed requirement. A significant number of those respondents requested that the Board clarify whether this proposed disclosure should be provided on a pre-consolidation/eliminations or a postconsolidation/eliminations basis. They noted that there is diversity in practice on how to present intercompany transactions under the current SEC requirement.

34. The staff performed additional outreach with stakeholders following the conclusion of the comment letter period because there were significant comments raised on whether the disclosure of pretax income (loss) and income tax expense (or benefit) should be made pre-consolidation/eliminations or postconsolidation/eliminations.

35. The staff spoke with six auditors and one preparer. Four of the stakeholders thought that pre-consolidation/elimination amounts would be more transparent than postconsolidation/elimination amounts because the pre-consolidation/elimination amounts give users information that they would need when assessing potential tax exposure in a particular jurisdiction. However, those stakeholders raised concerns that the preconsolidation/elimination amounts do not agree with the income statement. Some auditors said that the preconsolidation/elimination amounts should be reconciled to the income statement by including an eliminations column in the proposed disclosure. However, one auditor explained that this proposed disclosure

could lead to audit complexities because although an entity has the intercompany information available, it is not necessarily at the level of detail that would need to be provided if it were in the notes to the financial statements.

Income Taxes Paid

36. The amendments in the proposed Update include a requirement for entities to disclose income taxes paid disaggregated between domestic and foreign and the amount of income taxes paid to any country that is significant to total income taxes paid. There were 31 respondents that commented on the proposed requirement. About half of those respondents opposed the requirement, two-fifths supported the requirement, and the remaining respondents conditionally agreed with the requirement.

37. Respondents that conditionally agreed with the proposed disclosure either:

    (a) Favored disclosing domestic and foreign taxes paid but did not favor disaggregating taxes paid by significant country

    (b) Requested that the term *significant* be defined qualitatively, quantitatively, or both or be replaced with the term *material* for which guidance exists under the proposed Update on Topic 235.

38. There were 10 preparers/preparer associations and 1 accounting society that opposed the proposed requirement that commented that the proposed disclosure would not be useful or provide predictive value for users because of 1 or more of the following reasons:

    (a) Tax payments for individual jurisdictions are affected by items unrelated to current-year profit or loss such as book-tax differences, audit settlements, refunds, estimated payments, and utilization of tax attributes

    (b) Timing of payments varies by jurisdiction.

39. To address issues (a) and (b) above in paragraph 38 one auditor that conditionally agreed with the requirement suggested that entities should be required to align income taxes paid to related tax years.

Government Assistance

40. The amendments in the proposed Update include a requirement to disclose the description of a legally enforceable agreement with a government, including the duration of the agreement, the commitments made with the government under that agreement, and the amount of benefit that reduces or may reduce its income tax burden.

41. There were 25 respondents that commented on the proposed disclosure. Two-fifths of those respondents were opposed to the proposed disclosure, two-fifths conditionally agreed, and the remaining respondents supported the proposed disclosure. Many of the comments raised by the respondents in paragraphs 42–46 of this handout are similar to those from proposed Accounting Standards Update, *Government Assistance (Topic 832): Disclosures by Business Entities about Government Assistance*.

42. Eight preparers/preparer associations, one auditor, and one other respondent said that many government agreements contain confidentiality restrictions or are subject to laws that prohibit disclosure to third parties. Six of those respondents stated that the proposed disclosure should be limited to information that does not violate these confidentiality agreements. Four of those respondents would support the proposed requirement if confidential agreements are scoped out. One preparer association and an auditor suggested that a scope exception be provided similar to that in GASB Statement No. 77, *Tax Abatement Disclosures*,[1] and the proposed Update on Topic 832,[2] respectively, which allow for nondisclosure of specific provisions of an

[1] Paragraph 9 of GASB Statement 77 states that "governments that are legally prohibited from disclosing specific information required by this Statement may omit that information, subject to the requirements of paragraphs 7f and 8e." Paragraphs 7f and 8e of GASB 77 state that "if a government omits specific information required by this Statement because the information is legally prohibited from being disclosed, a description of the general nature of the tax abatement information omitted and the specific source of the legal prohibition" should be disclosed.

[2] On June 8, 2016, the Board tentatively decided that if an entity omits specific information required by the final Update on Topic 832 because the information is legally prohibited from being disclosed, the entity should disclose a description of the general nature of the information omitted and the specific source of the legal prohibition.

agreement because of legal prohibition and only require a description of the general nature of the agreement.

43. Two auditors, one preparer, and one accounting society that opposed the proposed requirement stated that the current rate reconciliation requirement in Topic 740 already provides adequate disclosure because any significant government assistance that reduces an entity's income tax rate would be disclosed in the rate reconciliation. The auditors said that the current requirement on government grants in paragraph 740-10-50-9(d) is adequate.

44. Eight preparers/preparer associations, five auditors, two accounting societies, and two other respondents stated that they would support the proposed disclosure if the Board clarifies or changes the scope of the proposed disclosure in one or more of the following ways:

    (a) Limit the scope of the proposed disclosure to tax holidays, which is an existing SEC requirement.

    (b) Scope out advance pricing agreements and private letter rulings because the primary purpose of those agreements is to confirm expected tax treatment with the taxing authority of a government, not to convey potential tax exposure to users.

    (c) Add clarification in the circumstance that an "entity meets the applicable eligibility requirements that are broadly available to tax payers without specific agreement between the entity and the government" (proposed paragraph 740-10-50-23). One auditor stated that the Board should remove the phrase "without specific agreement between the entity and the government" from proposed paragraph 740-10-50-23 so that an entity would not be required to disclose arrangements about government assistance that reduce its income taxes and that are broadly available but for which a specific agreement is still required.

    (d) Clarify the phrase "legally enforceable agreement" to reduce diversity in practice. One respondent said that the Board should remove the phrase "legally enforceable agreement" in its entirety. An accounting society stated that the scope should be expanded to include nondiscretionary assistance programs because government assistance is essentially the same whether it is under a legally enforceable agreement or nondiscretionary.

45. Nine respondents noted that the proposed disclosure on government assistance is not operable or auditable for the reasons discussed in paragraphs 42–44 of this handout. One auditor and preparer association noted that the requirement would be practically difficult for entities to apply without limiting the scope. Another auditor said that most companies do not have the systems and processes to track all of their government agreements.

46. Seven respondents said that the proposed disclosure on government assistance would be overly costly for the reasons discussed in paragraphs 42–44 of this handout. One preparer stated that entities should disclose agreements in the aggregate because disclosing individual agreements would be difficult and costly. However, an auditor stated that it is unclear how an entity could provide meaningful disclosure of agreements in the aggregate given there are dissimilar terms and conditions.

Change in Tax Law

47. The amendments in the proposed Update include a requirement to describe an enacted change in tax law that is probable to have an effect in a future period. There were 20 respondents that commented on the proposed disclosure. Over half of those respondents opposed the proposed disclosure and one-fourth conditionally agreed with the proposed disclosure. The remaining respondents supported the proposed disclosure.

48. Four preparers/preparer associations and four auditors said that the proposed disclosure would be costly and complex to prepare because probability would have to be assessed quantitatively, requiring significant judgment by preparers. Two of those respondents said that this was especially true for small entities or entities other than public business entities. Auditors also would have difficulty in objectively verifying the projections.

49. Six preparers/preparer associations, three auditors, and one accounting society said that the proposed disclosure was forward looking and, therefore, more appropriate for the Management Discussion and Analysis section. Four of those respondents conditionally agreed with the proposed disclosure as long as it is limited to a qualitative description. Those respondents said that the proposed disclosure would be useful, operable, and auditable.

Carryforwards

50. The amendments in the proposed Update include the following requirements on carryforwards for public business entities:

    (a) Disclose the amounts of federal, state, and foreign carryforwards (no tax effect) by time period of expiration for each of the first five years after the reporting date and a total amount for any remaining years.

    (b) Disclose the amounts of deferred tax assets for federal, state, and foreign carryforwards (tax effect) before the valuation allowance. Those amounts should be further disaggregated by time period of expiration for each of the first five years after the reporting date and a total amount for any remaining years.

    Entities other than public business entities would disclose the total amounts of federal, state, and foreign carryforwards (no tax effect) and their expiration dates.

51. There were 23 respondents that commented on these proposed requirements. Half of those respondents conditionally agreed with the proposed requirements, one-fourth supported them, and one-fourth opposed them. The following components of the proposed requirements were cited as concerns for those respondents that either opposed or conditionally agreed with the proposed carryforward disclosures:

    (a) Valuation allowance related to carryforwards

    (b) Gross carryforwards (no tax effect)

    (c) Expiration dates of carryforwards.

    Paragraphs 52–57 of this handout further explain the respondents' concerns.

Valuation Allowance Related to Carryforwards

52. Four respondents stated that the guidance in proposed paragraph 740-10-50-6A(b) should be presented net of valuation allowances. Several preparers and an industry association said that the net basis is more useful because it is the realizable amount. Additionally, the disclosure about the expiration dates is not useful if it comes before the amount of the valuation allowance. A preparer said that a user may incorrectly infer that these deferred tax assets are set to expire and will result in an income tax expense when, in fact, there is a valuation allowance associated with the deferred tax assets that could result in those deferred tax assets being lower. Two additional respondents opposed the proposed requirement and stated that current disclosure requirements are adequate.

53. Two preparers/preparer associations and a tax research organization recommended changing the proposed carryforward requirements to disclose either:

    (a) The amount of deferred tax asset available for loss and credit carryforward (net of valuation allowance)

    (b) All carryforwards on an aggregate tax-effected basis, net of valuation allowance for the respective federal, state, and foreign carryforwards.

    They said that such a change would be meaningful because it would provide users with estimated future cash flow information on carryforwards.

54. An accounting society stated that the proposed requirement for entities other than public business entities in paragraph 740-10-50-8A, net of valuation allowance, would be sufficient for public business entities. This respondent noted that users would want to see the deferred tax assets for carryforwards (net of valuation allowance) by year of expiration because those amounts would help predict future cash flows.

Gross Carryforwards (No Tax Effect)

55. Six preparers/preparer associations and a tax research organization were opposed to disclosing the gross (no tax effect) amount of carryforwards. The tax research organization stated that disclosure of gross information would not be useful and could

be misleading because users do not have the specialized knowledge to compute the tax effect of each attribute.

56. One auditor and four preparers/preparer associations noted that gross amounts of state carryforwards can be misleading because the value of a carryforward can vary significantly depending on state apportionments and state effective rates.

Expiration Dates of Carryforwards

57. Seven preparers/preparer associations said that the expiration dates of carryforwards are not decision useful. Four respondents recommended disclosing the expiration dates of carryforwards in fewer time bands. They said that a disclosure of the amount of carryforwards by time period of expiration for each of the first five years after the reporting date is costly and does not lead to more decision-useful information. Some respondents also said that the expiration dates of carryforwards are not representative of the timing in which a tax carryforward may be used because the disclosure does not take into consideration the existence of a valuation allowance (see paragraphs 52–54 of this handout).

Unrecognized Tax Benefits

Disaggregation of Settlements between Deferred Tax Assets and Cash

58. The amendments in the proposed Update include a requirement for public business entities to disclose within the reconciliation of the total amounts of unrecognized tax benefits at the beginning and end of the period settlements using existing deferred tax assets separate from those that have been or will be settled in cash. There were 11 respondents that commented on this proposed disclosure. Half of those respondents supported the proposed amendment, and half were opposed.

59. Five preparers/preparer associations stated that separating settlements using existing deferred tax assets from those settled in cash may be challenging. One preparer noted that while an entity may know the total change in liability for the period, it may not know the portion attributable to cash settlement. Two preparers/preparer associations said that when a deferred tax asset is used to offset a tax liability upon an audit settlement, the deferred tax asset is not always associated with a corresponding tax

liability but, rather, the tax liability is applied to the entity's total liability for the period. Three preparers/preparer associations stated that to comply with the proposed disclosure, entities would be required to arbitrarily allocate the deferred tax asset utilization against unrecognized tax benefits, which would not result in decision-useful information. One accounting association said that this proposed change would result in an incremental disclosure requirement that is not beneficial for users.

Line Items in Which Unrecognized Tax Benefits Are Presented

60. The amendments in the proposed Update include a requirement for public business entities to disclose the ending balance of unrecognized tax benefits by statement of financial position line item. If the unrecognized tax benefits are not presented in the statement of financial position, entities should disclose that amount separately. There were 11 respondents that commented on this proposed disclosure. Half of those respondents supported the proposed disclosure, and the other half opposed it.

61. Four preparers/preparer associations stated that this requirement does not provide decision-useful information and that current requirements in paragraph 740-10-50-15A (see below) are sufficient.

> **740-10-50-15A** Public entities shall disclose both of the following at the end of each annual reporting period presented:
>
> a. A tabular reconciliation of the total amounts of unrecognized tax benefits at the beginning and end of the period, which shall include at a minimum:
>   1. The gross amounts of the increases and decreases in unrecognized tax benefits as a result of tax positions taken during a prior period
>   2. The gross amounts of increases and decreases in unrecognized tax benefits as a result of tax positions taken during the current period
>   3. The amounts of decreases in the unrecognized tax benefits relating to settlements with taxing authorities
>   4. Reductions to unrecognized tax benefits as a result of a lapse of the applicable statute of limitations.
>
> b. The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate.
>
> See Example 30 (paragraph 740-10-55-217) for an illustration of disclosures about uncertainty in income taxes.

62. One preparer association and an auditor stated that it is not clear what unrecognized tax benefits would not be presented in the statement of financial position.

Remove Requirement to Disclose Unrecognized Tax Benefits That Are Reasonably Possible to Change

63. The amendments in the proposed Update would eliminate paragraph 740-10-50-15(d), which currently requires disclosure of the nature and estimate of the range of the reasonably possible change in the unrecognized tax benefits balance in the next 12 months or a statement that an estimate of the range cannot be made. There were 12 respondents that commented on the proposed elimination. Two-thirds of those respondents agreed with the Board's decision to remove the requirement, and one-third of them opposed the proposed elimination.

64. An auditor that opposed the removal stated:

> This disclosure is critical because of the highly judgmental nature of unrecognized tax benefits; its inclusion mitigates risk to both the reporting entity and its audit firm.…this requirement is consistent with the general "early warning" disclosure requirement under paragraph 275-10-50-8, and thus should be retained. [CL #24]

Rate Reconciliation

65. The amendments in the proposed Update include a change to the existing rate reconciliation requirement for public business entities to be consistent with SEC Regulation S-X 210.4-08(h). The proposed amendment would require public business entities to (a) separately disclose any reconciling item that amounts to more than 5 percent of the amount computed by multiplying the income before tax by the applicable statutory federal income tax rate and (b) explain the changes in those reconciling items from year to year. There were 14 respondents that commented on the proposed amendment. About half of those respondents supported the proposed amendment, about half conditionally agreed with the proposed amendment, and the remaining two respondents opposed the proposed amendment

66. One preparer association agreed with the Board's intent to align the requirement with the SEC regulation but disagreed with the requirement to explain the year-to-year changes in the reconciling items because it would lead to extensive explanations that may not be useful. The preparer association said that existing paragraph 740-10-50-14 is better than the proposed change because it would trigger a decision-useful

explanation if there are significant or unusual changes. Paragraph 740-10-50-14 states:

> If not otherwise evident from the disclosures required by this Section, all entities shall disclose the nature and effect of any other significant matters affecting comparability of information for all periods presented.

67. One auditor recommended that the Board retain the requirement to present "significant reconciling items" and not include a specific percentage threshold because the 5 percent threshold may result in disclosure of items that are "insignificant in relation to income from continuing operations when the federal income tax rate of a non-U.S. entity is significantly lower than the U.S. federal corporate income tax rate" (CL #32). An accounting society said that the threshold should be reconciling items that reflect materiality to the entity.

Valuation Allowance

68. The amendments in the proposed Update include a requirement to disclose the amount and explanation of the valuation allowance recognized or released during the reporting period. Eight respondents commented on the proposed disclosure. Half of those respondents conditionally agreed with the proposed disclosure, two supported it, and two opposed it.

69. One auditor said that the proposed disclosure is redundant with existing disclosures in paragraphs 740-10-50-2 and 740-10-50-12 (see below):

> **740-10-50-2** The components of the net **deferred tax liability** or **asset** recognized in an entity's statement of financial position shall be disclosed as follows:
>
> a. The total of all deferred tax liabilities measured in paragraph 740-10-30-5(b)
> b. The total of all deferred tax assets measured in paragraph 740-10-30-5(c) through (d)
> c. The total **valuation allowance** recognized for deferred tax assets determined in paragraph 740-10-30-5(e).
>
> The net change during the year in the total valuation allowance also shall be disclosed.
>
> **740-10-50-12** A public entity shall disclose a reconciliation using percentages or dollar amounts of the reported amount of income tax expense attributable to continuing operations for the year to the amount of income tax

> expense that would result from applying domestic federal statutory tax rates to pretax income from continuing operations. The statutory tax rates shall be the regular tax rates if there are alternative tax systems. The estimated amount and the nature of each significant reconciling item shall be disclosed.

70. Three preparers/preparer associations stated that the proposed disclosure would be too voluminous and complex for users to understand. One of those respondents suggested disclosing the amount and explaining the change in valuation allowance only when it is a reconciling item in the rate reconciliation.

Transition, Implementation, and Adoption

71. There were 25 respondents that commented on transition. Of those 25 respondents, four-fifths supported prospective application of the proposed requirements. Half of those that supported prospective application also stated that retrospective adoption should be allowed but not required. Five respondents supported retrospective application.

72. There were 15 respondents that commented on implementation period. One-third of those respondents supported a one-year implementation period. Those respondents said that one year would give most entities sufficient time to gather the information necessary for the proposed disclosures. Three respondents supported a two-year implementation period, and another three stated that significant time would be needed to implement the proposed requirements. Those respondents said that some of the proposed disclosures would require implementation of additional systems and processes and the collection of large amounts of data. The remaining respondents stated that significant time would not be needed to implement the requirements. Two respondents asked that the Board consider the time and effort that entities would need to implement Topic 842, Leases, and Topic 606, Revenue from Contracts with Customers, when determining an effective date for proposed amendments.

73. There were 13 respondents that commented on whether the amount of time needed to implement the proposed amendments by entities other than public business entities should be different from the amount of time needed by public business entities. A little over half of those respondents stated that an additional year should be allowed for entities other than public business entities because they do not have the same

accounting abilities as public business entities and they can learn and observe from public business entity implementation. The remaining respondents said that entities other than public business entities should not have additional implementation time.

74. There were 16 respondents that commented on whether early adoption should be permitted. Almost all of those respondents supported early adoption.

Materiality

75. There were 12 respondents that commented on materiality (proposed Update on Topic 235). As discussed in paragraph 6 of this handout, the Board discussed broader materiality issues at the December 14, 2016 Board meeting.

76. One user (accounting analyst) and one other respondent stated that entities do not want to disclose tax information and that the Board's materiality proposals will give the entities too much discretion to omit important information.

77. Two preparers/preparer associations and one state society supported the statement in paragraph 740-10-50-1 of the proposed Update on Topic 740 that "a reporting entity does not need to provide disclosures required by [the] Subtopic if the disclosures are immaterial." One auditor said that it supports the elimination of phrases such as "an entity shall disclose at minimum" and that the application of materiality is particularly important to Topic 740. Another preparer said that it agrees with the SEC's current definition of materiality.

78. One auditor and one preparer said that entities may incur additional costs to assess whether disclosures are immaterial. One auditor and two preparers/preparer associations requested that the Board provide additional guidance on the application of materiality to either the disclosure of the change in tax law or the disclosure of the change in government agreements.

Questions for the Board
1. Does the Board have questions on the comment letter respondent feedback?
2. In addition to the issue on intercompany transactions described in paragraphs 34–35 of this handout, what research would the Board like the staff to perform in advance of the March 2017 public roundtable meetings and redeliberations?

3. Does the Board agree with the staff’s next steps? If not, what would the Board like the next steps to be?