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February 2, 2018

Mr. Russell G. Golden
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

RE: Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income

Dear Mr. Golden,

CFA Institute,[1] in consultation with its Corporate Disclosure Policy Council ("CDPC")[2], CFA Institute appreciates the opportunity to comment on the *Proposed Accounting Standards Update, Income Statement – Reporting, Comprehensive Income* (the "Proposed Update").

CFA Institute is comprised of more than 130,000 investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. CFA Institute seeks to promote fair and transparent global capital markets and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that the quality of corporate financial reporting and disclosures provided to investors and other end users is of high quality.

We have reviewed the Proposed Update and have the following comments:

1) ***Terminology & Illustrative Examples*** **–** We have included an example with journal entries at **Attachment A** to illustrate the issue being addressed combined with the FASB's proposal to address it. We include such illustration to ensure we, our members (who we respond on behalf of) and other investors, fully understand the issue and the FASB's proposal. We have developed this illustration using the unrealized gain/loss on investment securities as it provides a simple illustration of the deferred tax effects "stranded" in accumulated other comprehensive income (AOCI) which is the subject of

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[1] With offices in Charlottesville, New York, Hong Kong, Brussels, London, Mumbai and Beijing CFA Institute is a global, not-for-profit professional association of more than 133,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 151 countries, of whom more than 125,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 145 member societies in 70 countries and territories.

[2] The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

this Proposal. We recognize that other elements of accumulated other comprehensive income including those related to pension and other post-retirement obligations and cash flow hedges are similarly impacted.

2) ***Eliminate Deferred Tax Adjustment to Earnings or Reclass Between AOCI & Retained Earnings*** **–** From the unsolicited comment letters, it appears some commenters are seeking a balance sheet only reversal of the deferred tax effects rather than retaining the U.S. GAAP requirement to recognize the tax effects of the 2017 Tax Cut and Jobs Act (2017 Tax Act) on the income statement. We note the request of several of the commenters relative to the U.S. GAAP requirement below:

US GAAP Requirement	Replacement for US GAAP Requirement
dr. deferred tax liability cr. deferred income tax expense	dr. deferred tax liability cr. deferred tax – AOCI (equity)
dr. deferred income tax expense cr. deferred tax asset	dr. deferred tax – AOCI (equity) cr. deferred tax asset

Paragraph 740-10-45-15[3] of the Codification states that any change in the tax rate should be reflected in continuing operations in the period of enactment.

It appears the deferred tax effects of the change in tax law become stranded because the aforementioned debit or credit to the deferred tax asset/liability and the deferred tax expense entry in the income statement leaves the amount previously recognized as deferred tax in accumulated other comprehensive income still recognized in equity.

We understand the Proposed Update would retain the U.S. GAAP requirement to reflect the enacted tax change on all deferred items (both those originating in the income statement and those origination through other comprehensive income) through continue operations and make an additional entry to reclassify the stranded effects from accumulated other comprehensive income to retained earnings. The FASB's proposal is reflected in the chart below:

US GAAP Requirement	FASB Proposal
dr. deferred tax liability cr. deferred income tax expense	dr. retained earnings cr. deferred tax – AOCI (equity)
dr. deferred income tax expense cr. deferred tax asset	dr. deferred tax – AOCI (equity) cr. retained earnings

[3] **Paragraph 740-10-45-15** states that when deferred tax accounts are adjusted as required by paragraph 740-10-35-4 for the effect of a change in tax laws or rates, the effect shall be included in income from continuing operations for the period that includes the enactment date.

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3) ***Investor Confusion*** – Our experience is that investors pay substantially less attention to the statement of stockholders' equity accounts – unless there has been a substantial equity transaction – than they do to the income statement. Simply reversing the deferred tax effect of the tax law change through accumulated other comprehensive income will draw no attention to the change in value of the deferred tax asset or liability on the value of the enterprise brought about by the 2017 Tax Act. As such, we do not support a balance sheet only adjustment as some have requested in their unsolicited comment letters.

   We do not believe investors will be confused by reflecting the tax effects of the 2017 Tax Act associated with items such as unrealized gains/losses (and other items residing in accumulated other comprehensive income) in the income tax expense caption on the income statement. Just as there are changes to deferred taxes on items originally reflected in earnings, investors want to understand the immediate impact of 2017 Tax Act on the value of the firm which is best reflected in earnings.

   Just as companies are explaining the overall effect to analysts and investors for the tax change, this too, can be explained.

   That said, it is important to reflect the items such as unrealized gains/loss on investment securities (and other elements of accumulated other comprehensive income) in equity at their appropriately tax effected amount in the statement of stockholders' equity as certain investors adjust equity for these amounts for certain analytical purposes.

   We traditionally do not support entries within equity which do not pertain to equity transactions; however, there is really no way possible to adjust accumulated other comprehensive income other than making a journal entry directly to retained earnings.

4) ***Why Not An Issue Before Now?*** – We understand that the implications of the 2017 Tax Act are quite significant and that there hasn't been this substantial a change in U.S. tax rates since 1986. That said, U.S. GAAP is applied in other countries, or by foreign subsidiaries of U.S. parent company's, where taxes rates have changed since 1986 and where the tax effects on those items in AOCI have had to be included in earnings previously. As such, we question why this mechanical anomaly in U.S. GAAP is only being identified at this juncture. A natural question for investors should be, are there legacy stranded effects from previous changes in tax rates sitting in accumulated other comprehensive income?

   Paragraph BC10 of the Proposed Update implies that other stranded effects will remain in accumulated other comprehensive income. If this is the case, we are not clear why the FASB would not allow adjustment at this time and in the future.

5) ***Balance Sheet Reconciliations*** – Most companies maintain general ledger "accumulated other comprehensive accounts" in equity but don't maintain "other comprehensive income accounts" in their ledgers. Other comprehensive income is generally a function

of the reporting process not the recording process for companies in the record to report cycle.

Each period, especially as it relates to investment securities, the accumulated other comprehensive income account entries from prior periods are reversed and rebooked at the end of the period with the new unrealized numbers and the recomputed tax impact under the balance sheet approach. This has the effect of forcing the equity and balance sheet accounts to the income statement and impacting the effective tax rate. The change in accumulated other comprehensive income is then reflected as other comprehensive income with reclassification entries being separately derived from the subsidiary ledger, for example, in the case of securities sold.

In theory, companies reflect items in other comprehensive income as they arise or reverse, but the reality is that most companies recompute and reestablish the accumulated other comprehensive income, and related tax effects, each period. This has the effect of "pushing" the stranded effects out of AOCI.

Further, when companies inventory, reconcile and verify balance sheet accounts to subsidiary records, they need to prove the appropriateness of the balance sheet accounts with underlying documentation. If this is the case, they should know the "stranded effects" and when the originated based upon such inventory. Accordingly, making any adjustments for these additional stranded effects should easily be "cleaned-up" at this time.

We believe, if this issue is significant enough to make an adjustment to Codification, then it is something which should be used to correct previous and future misclassifications between AOCI and retained earnings for such tax rate changes.

6) ***How Have Companies Having Already Released Earnings Addressed This Issue? –*** For those companies which have already released their U.S. GAAP earnings, investors need to understand how they have treated this issue in advance of this guidance.

   Are investors to assume they reflected the appropriate amounts in net income and that accumulated other comprehensive income and retained earnings are not appropriately stated? If that is the case, do those companies have incorrect accumulated other comprehensive income amounts which investors are adjusting for?

   See also our comments on transition as noted below.

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7) ***Effective Date & Transition* –** The Proposed Update is to be effective for all fiscal years beginning after December 15, 2018 with earlier application to be permitted in all cases where the financial statements have not yet been issued.

   While we support retroactive application of this standard, the early application raises several questions:

   a) Will public companies who have already issued their earnings release adopt and have a different retained earnings balance at issuance of the financial statements when compared to any amounts presented during the press release? If so, we think there should be prominent disclosure of such difference.
   b) Will there be substantial incomparable amounts in financial statements for those who chose not to early adopt? If so, we believe companies should clearly disclose the proposed reclassification expected in 2018 related to 2017.

   Because of the lack of comparability which may result, we recommend the FASB make the accounting in the Proposed Update immediately mandatory for all companies who have not yet issued their financial statements. For those who have issued financial statements we recommend they be required to adopt at the next interim or annual date where such previously reported amounts are represented.

8) ***Prudential Regulation* –** We understand some have expressed concern regarding the impact a failure by the FASB to address this issue will have on regulatory capital. We computed such impact in **Attachment A** to ensure we understood the impacts being discussed.

   We have always noted that prudential regulators have the ability to issue relief in regulatory filings and that U.S. GAAP should not be guided by prudential regulatory requirements. We note that the regulators have done just this and are allowing banking institutions to adjust their reporting as the FASB has proposed, even before issuance of the Proposed Update.

9) ***Treatment Under IFRS* –** Investors invest globally and need to understand if this issue exists for IFRS as well as U.S. GAAP. The proposed update does not comment on whether this Proposed Update creates a difference between IFRS and U.S. GAAP. We understand IFRS would allow the balance sheet approach proposed by some commenters. Thereby there is a difference between U.S. GAAP and IFRS on the treatment of such deferred tax changes in AOCI and no need for this proposed adjustment.

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Thank you again for the opportunity to comment on the Proposed Update. If you or your staff have questions or seek further elaboration of our views, please contact Sandy Peters by phone at +1.212.754.8350 or by email at sandra.peters@cfainstitute.org.

Sincerely,

/s/ Sandra J. Peters
Sandra J. Peters, CFA
Head, Financial Reporting Policy
Advocacy Division
CFA Institute

/s/ Ashwinpaul C. Sondhi
Ashwinpaul C. Sondhi
Chair
Corporate Disclosure Policy Council

cc: Corporate Disclosure Policy Council

ATTACHMENT A

INVESTMENT SECURITIES IMPACTED BY TAX RATE CHANGE

T=0

Bonds	2,100
Unrealized Loss	(1,000)
Market Value	1,100
Deferred Tax Asset	350

Tax rate declined from 35% to 21%, between T=0 and T=1, but no change in unrealized on bond.

T=1

Bonds	2,100
Unrealized Loss	(1,000)
Market Value	1,100
Deferred Tax Asset	210

JOURNAL ENTRIES

#1		
Dr. Bonds	2,100	
Cr. Capital Stock		100
Dr. Retained Earnings		2,000
#2		
Dr. Unrealized Gain/Loss – Bonds	1,000	
Cr. Unrealized Gain/Loss – Equity		1,000
#3		
Dr. Deferred Tax Asset	350	
Cr. Deferred Tax Asset – Equity		350

Entry Required By Existing GAAP

#4		
Dr. Deferred Tax Expense	140	
Cr. Deferred Tax Asset		140

Additional Entry Proposed By ASU

#5		
Dr. Deferred Tax Asset – Equity	140	
Cr. Retained Earnings		140

ACCOUNT BALANCES

JOURNAL ENTRIES

ASSETS

Bonds

Dr.	Cr.
❶ 2,100	
2,100	

Unrealized Gain/Loss - Bonds

Dr.	Cr.
	❷ 1,000
	1,000

Deferred Tax Asset/Liability

Dr.	Cr.
❸ 350	
350	
	❹ 140
210	

EQUITY

Common Stock

Dr.	Cr.
	❶ 100
	100

Retained Earnings

Dr.	Cr.
	❶ 2,000
	2,000
❺ 140	
	1,860

Unrealized Gain/Loss - Equity

Dr.	Cr.
❷ 1,000	
1,000	

Deferred Tax Asset/Liability - Equity

Dr.	Cr.
	❸ 350
	350
❹ 0	
	350
❺ 140	
	210

Difference of $140 = "stranded effect" adjusted for in ❺.

INCOME STATEMENT

Deferred Tax Expense

Dr.	Cr.
❹ 140	
140	

PRUDENTIAL CAPITAL

T=0

Common Stock	100	100
Unrealized Gain/Loss – Equity	(1,000)	
Deferred Tax Asset – Equity	350	
Retained Earnings	2,000	2,000
	1,450	2,100

T=1 (Assuming No Entry from Proposed ASU)

Common Stock	100	100
Unrealized Gain/Loss – Equity	(1,000)	
Deferred Tax Asset – Equity	350	
Retained Earnings	1,860	1,860
	1,310	1,960

T=1 (Assuming Including Entry from Proposed ASU)

Common Stock	100	100
Unrealized Gain/Loss – Equity	(1,000)	
Deferred Tax Asset – Equity	210	
Retained Earnings	2,000	2,000
	1,310	2,100

T=1 (Assuming Including Entry Directly to Equity)

Common Stock	100	100
Unrealized Gain/Loss – Equity	(1,000)	
Deferred Tax Asset – Equity	210	
Retained Earnings	2,000	2,000
	1,310	2,100