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Accounting & Auditing Update

Amendments to Income Statement — Reporting Comprehensive Income (Topic 220) Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income

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The Financial Accounting Standards Board (FASB or Board) recently issued Accounting Standards Update (ASU) No. 2018-02, ***Income Statement—Reporting Comprehensive Income*** (Topic 220). This ASU was issued in response to concerns expressed to the Board by stakeholders regarding accounting for the tax effects of items included within accumulated other comprehensive income (AOCI) as a result of the enactment of the Tax Cuts and Jobs Act of 2017 (TCJA or Tax Act).

Option to Reclassify

Current U.S. generally accepted accounting principles (GAAP) requires deferred tax assets and liabilities included within AOCI to be adjusted for the effect of changes in tax rates and laws, with the resulting effect included in income from operations (i.e., within the deferred income tax provision). This accounting treatment is applicable even when the item(s) within AOCI were never recognized in the income statement (i.e., they originated in AOCI). Under the new ASU, at the option of the financial statement preparer, the aforementioned adjustment may be reclassified from AOCI directly to retained earnings.

AOCI Items and Example

Items typically found in AOCI include:

- Unrealized gains/losses on available-for-sale securities
- Changes in fair value of derivatives that qualify for hedge accounting and
- Pension and post-retirement benefit actuarial gains/losses

A simple example of the application of the ASU follows:

> An entity has $100 of temporary differences (assume an asset) that are in AOCI, net of a federal deferred tax liability of $35. Due to the enactment of the Tax Act, the entity is required to re-measure the aforementioned deferred tax liability using the lower 21% tax rate which results in a $14 stranded tax effect [$14 = $100*(35% - 21%)] within AOCI. Under the ASU, the $14 stranded tax effect may be credited to retained earnings rather than included in the deferred income tax provision within the income statement.

Effective Dates

The ASU is effective as follows:

For all entities, for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years.

Early adoption is permitted.

How the ASU Should be Applied

The amendments in the ASU should be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Act is recognized.

Disclosures

The ASU requires various disclosures to be made in the financial statements about the stranded tax effects, including, but not limited to:

- Description of accounting policy for releasing income tax effects from AOCI.
- Whether the company elects to reclassify the stranded income tax effects from the TCJA.
- Information about the other income tax effects that are reclassified.

Contact Us

Should you have any questions regarding this matter, please feel free to reach out to your PKF O'Connor Davies partner or Robert Rollmann, CPA, CGMA, Partner at rrollmann@pkfod.com or 914.421.5605.

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