FASB Addresses Stranded AOCI; Deferred Tax Adjustments Impact Earnings in 2017

Issue: Stranded Accumulated Other Comprehensive Income (AOCI) is a result of tax reform and deferred tax adjustments recorded in income tax expense related to amounts that are normally recorded in AOCI (e.g. unrealized gains and losses on AFS bonds and certain hedging transactions).

The Financial Accounting Standards Board (FASB) held a meeting on January 10, 2018 to discuss the financial reporting effects of the Tax Cuts and Jobs Act signed into law on December 22, 2017. Stakeholders in the banking and insurance industries raised financial reporting issues by submitting unsolicited comment letters to the FASB regarding amounts stranded in AOCI as a result of tax reform. The purpose of the Board meeting was to decide whether to add a project to the Board's agenda on the reclassification of certain tax effects from AOCI to retained earnings (RE) and make technical decisions if the Board decided to add the project to its agenda.

Accounting Rules and Challenges: Changes in tax rates and tax laws require a reevaluation and adjustment to deferred tax accounts when tax law changes are signed into law, not when the tax law changes are effective. Most banks are in a net deferred tax asset (future tax deduction) position, which arises from various timing differences, including unrealized losses on bonds classified as available for sale (AFS), which are marked to market through AOCI, net of tax. Deferred adjustments due to the lowering of the corporate tax rate from 34% or 35% to 21% should be recorded in 2017 as an adjustment to income tax expense.

The adjustment of deferred tax accounts to income tax expense and not to AOCI is the cause of the amount stranded in AOCI, which creates issues going forward, if not address by the FASB, including: the reversal of AOCI to income tax expense as the bond is retired or disposed and also creates accounting difficulties as the amount stranded in AOCI would have to be tracked over time, which can be exceedingly complex and cumbersome.

FASB Actions at Board Meeting:

1. Added a project to the technical agenda to address the reclassification of certain tax effects presented in accumulated other comprehensive income to retained earnings
2. Approved a one-time reclassification (from AOCI to RE) for the newly enacted corporate tax rate and will perform further research on the broader issue of backwards tracing as part of a separate research project
3. Set the transition method, transition disclosures, and adoption periods, including early adoption

The FASB reached a tentative Board decision and is expected to issue an exposure draft (ED) followed by a 15-day comment period. The Board approved an effective date of the proposed Accounting Standards Update (ASU) for fiscal years beginning after 12/15/18 or for interim periods within those fiscal years for both public and private companies, with early adoption permitted. The requirement would be applied retrospectively to the date of enactment if the forthcoming accounting guidance is not adopted early.

Due to the timing of earnings releases and call report filing deadlines, many companies may be forced to issue year-end financial statements and call reports utilizing current accounting pronouncements. For customers utilizing our Bond Accounting services, we have developed reporting tools to assist in tracking stranded AOCI, and subsequent release or reversal of AOCI to income tax expense as the bond is retired or disposed.

We encourage you to contact your accounting and tax advisors to assist in evaluating the impact of tax law changes. Please reach out to your account representative and we will be happy to assist.

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