fei committee on corporate reporting

fei committee on taxation

May 31, 2019

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

Re: File Reference No. 2019-500

Dear Chairman Golden,

This letter is being submitted by Financial Executives International's (FEI) Committee on Corporate Reporting (CCR) and Committee on Taxation (COT) in response to the Financial Accounting Standards Board's (FASB or "the Board") Proposed Accounting Standards *Update Income Taxes (Topic 740) Disclosure Framework – Changes to the Disclosure Requirements for Income Taxes*. FEI is a leading international organization of more than 10,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives, and other senior-level financial executives. CCR and COT are technical committees of FEI. CCR reviews and responds to research studies, statements, pronouncements, pending legislation, proposals, and other documents issued by domestic and international agencies and organizations. COT formulates statements/positions on tax legislation, policies, practices, rules and regulations, addressing economic/social implications of taxes, simplification and administration, and tax and accounting relationships, and communicates these to the executive and legislative branches of the government. CCR and COT member companies collectively represent approximately $8.6 trillion in market capitalization and actively monitor the standard setting activities of the FASB.

This letter represents the views of CCR and COT and not necessarily the views of FEI or its members individually.

Executive Summary

CCR and COT support the FASB's disclosure framework project and its objective to improve the effectiveness of disclosures in notes to the financial statements. We commend the Board for revising its July 2016 exposure draft based on feedback from stakeholders and its evaluation of the effects of the Tax Cuts and Jobs Act (TCJA). We support the FASB's initiatives to revise the disclosure framework to focus on providing investors with decision-useful information while also making disclosures more efficient to prepare. Additionally, we support many of the revisions to the initial exposure draft which resulted in the removal of several previously proposed requirements. However, we are concerned that the Revised Exposure Draft still includes proposed disclosures that do not provide incrementally useful information and have the potential to inhibit clear communication with users. For many companies, certain proposed requirements will require significant additional effort and costs to prepare. Further, we believe the objectives of certain additional requirements are already satisfied by other existing disclosure requirements. For these reasons, we generally do not support the proposed disclosures described in the Revised Exposure Draft. However, if the Board deems it necessary to require increased disclosure to improve the effectiveness of the information provided to users, after assessing the cost benefit balance, then we urge the Board to consider the several recommendations included below. We believe these recommendations would improve the proposed disclosures by creating an income tax footnote that is more focused on the most material and decision-useful information. While we do present recommendations, because we do not fully agree with the problem(s) that this Revised Exposure Draft aims to solve, we have not offered significant alternatives to the proposed disclosures. If the informational needs being sought by users were more clearly defined, we would be better positioned to suggest more effective, efficient, and practical solutions than what is recommended in this document. Our recommendations and feedback more broadly are organized in the context of responses to the questions included in the Revised Exposure Draft. Unless specifically indicated otherwise, this letter is referencing the requirements for public business entities and any use of the words company, entity, etc., is in reference to public business entities.

Question 1: Would the amendments in this proposed update that add or modify disclosure requirements result in more effective, decision-useful information about income taxes? Please explain why or why not. Would the proposed amendments result in the elimination of decision-useful information about income taxes? If yes, please explain why. / Question 2: Are the proposed disclosure requirements operable and auditable? If not, which aspects pose operability or auditability issues and why? / Question 3: Would any of the proposed disclosures impose significant incremental costs? If so, please describe the nature and extent of the additional costs.

We do not believe that any of the proposed amendments eliminate decision-useful information about income taxes. However, we do question the usefulness and operability of the additional proposed requirements. Considering the comprehensiveness of the current income tax disclosure framework, we do not believe the additional disclosures will provide meaningful incremental information or value to users of the financial statements.

<u>Income Taxes Paid</u>

The proposed update would require the disclosure of income taxes paid disaggregated between federal, state, and foreign jurisdictions, in order to provide additional information regarding net cash flows related to income taxes. Consistent with feedback previously provided, we continue to have concerns regarding the usefulness of this information, and for some companies, the operability of providing it. The timing of cash taxes paid rarely correlates directly to when actual earnings are reported, because tax payments in any given period may include the effects of both current and prior periods. Tax payments often include the effect of prior year audit settlements, refunds, deposits, penalties, tax credits, and other effects resulting from the interaction of varying tax systems across jurisdictions, including jurisdictions that tax income on a worldwide basis. Thus, the information may be confusing to the financial statement user, or at minimum have little or no predictive value on the future cash tax flow due to the many factors that can contribute to one payment. These usefulness concerns are also true at any given interim period.

In addition to the usefulness of these proposed disclosures, we have concerns about the operability of these requirements. For some companies, the collection of income tax payments by jurisdiction is cumbersome and time-consuming. Multinational companies with nonintegrated subsidiaries and decentralized operations are most likely to spend significant time and effort to gather this information. This time and effort may be required because the information may not be readily available and could potentially take weeks to collect from various jurisdictions within the United States and around the world, especially considering the different methods and due dates for tax payments across jurisdictions. Many companies' systems are not currently capable of compiling this information, in many cases because management does not require it for operating the business. Thus, in order to meet this proposed requirement and file within the required deadline, some companies would need to implement new system solutions or substantial upgrades, causing them to incur significant systems costs and process changes globally. The investment of time and capital resources could be burdensome for many companies. Within CCR and COT member companies, we acknowledge the degree of challenge and related costs may vary; however, we believe the significance of the effort and costs to the companies that do fit this scenario warrants consideration by the Board as it finalizes its proposal.

Finally, these operational challenges are amplified if income tax payments are required to be disclosed in interim financial statements, even without the requirement to disaggregate by jurisdiction. For those companies most severely impacted, the amount of time and effort required to gather the relevant data is likely not feasible, especially given it is unlikely the information will be available from all relevant jurisdictions in time for interim reporting. Thus, if this amendment were to be approved, we are concerned that the difficult and time-consuming nature of collecting tax payment data could delay the timing of interim filings. We believe that timeliness is a main objective of interim reporting and important to many users who would be negatively affected by this required disclosure.

For these reasons and because it is unclear what additional decision-useful information is provided, we recommend that the Board remove both proposed amendments regarding cash taxes paid (i.e. the amendment that would require income taxes paid, disaggregated between federal or national, state, and foreign and the amendment to require disclosure of income taxes paid during the interim period in interim financial statements).

Valuation Allowance Disclosure

The proposed update would require companies to disclose the amount of the valuation allowance recognized and released each period along with an explanation of the changes. We believe that this information is already included through the existing income tax disclosure requirements and the Management Discussion and Analysis (MD&A) section, where material financial statement changes should be discussed. Currently, in the rate reconciliation, companies are required to disclose material income statement impacts related to adjustments to the beginning-of-the-year balance of a valuation allowance and the effects of changes in the valuation allowance on deferred tax assets. Therefore, we believe that the objective of providing users with relevant information regarding the most significant and meaningful variations in the valuation allowance is being satisfied by these existing sources of information. Therefore, we recommend the Board remove the proposed additional disclosures.

Carryforward Disclosure

We appreciate the change the Board made in this Revised Exposure Draft, to remove the requirement to present loss carryforwards disaggregated by federal, state, and foreign on a pre-tax basis, requiring instead that these amounts be presented tax-effected. We believe this change will help to provide a more focused and useful disclosure while also easing the effort for preparers. However, we continue to believe that the proposed requirement to disaggregate the deferred tax assets for net operating loss carryforwards (NOLs) by each of the first five years subsequent to the reporting date can be potentially misleading and does not provide decision-useful information. Companies are required to record valuation allowances for any carryforward that will expire unused. Therefore, the expiration of carryforwards is already encompassed in the net deferred tax asset balance. Additionally, NOLs do not expire in many countries, including the United States under the TCJA, and these NOLs are often the largest portion of a company's carryforwards. Further, carryforward expiration dates do not accurately represent when a carryforward will be used; companies can use a carryforward at any period before the expiration date, if eligible. For these reasons, we believe the benefits of disaggregating carryforwards by expiration period is significantly limited and may be misleading to investors. We recommend the Board remove the proposed amendment requiring disaggregation by the subsequent five years and continue to require companies to disclose information regarding carryforward expirations using a method that is most helpful to their investors.

Question 4: One of the proposed amendments would require entities to disclose pretax income (or loss) from continuing operations before intra-entity eliminations disaggregated between domestic and foreign, which initial feedback indicated would reduce diversity in practice. Would this proposed amendment be operable? Should the Board specify whether the disclosed amounts should be before or after intra-entity eliminations? Why or why not?

The SEC currently requires the disclosure of income (or loss) from continuing operations before income tax expense (or benefit) disaggregated between domestic and foreign components. We are supportive of the Board's efforts to make U.S. GAAP more consistent with SEC requirements, however, this proposed amendment would reduce consistency by specifying pretax income (or loss) from continuing operations be presented before intra-entity eliminations – SEC regulations do not specify a method. Currently, we are not aware of any CCR or COT member companies that present income from continuing operations before intra-entity eliminations. We offer the Board the following considerations regarding the operability and usefulness of this disclosure.

Operability

Under current U.S. GAAP, companies are required to eliminate intra-entity transactions in consolidation. Therefore, this disclosure amendment would be difficult to operationalize, because it would require companies to change existing processes, controls, and potentially systems to present this information before eliminations. For many, this would involve significant time, effort, and costs. For example, different ERP systems use different methods for handling intra-entity eliminations for different types of transactions. Some systems account for these transactions directly through equity, while others account for them in the income statement (but within multiple applications of the ERP system). Further, many companies have consolidations or eliminations ledgers that include more than just intra-entity eliminations. These ledgers can be used to record adjusting entries for consolidation purposes that are not required in a specific legal entity's ledger. In these circumstances, it would require significant effort to separate entries into amounts that are reported in pre-elimination geographic income rather than the post-intra-entity elimination amount that is excluded from the reported amounts. This may require significant efforts by companies to reconfigure their ERP systems. This work would be particularly challenging and difficult to operationalize within the relatively short period to file financial statements.

Similarly, the need to report pre-tax income (or loss) before intra-entity eliminations could be difficult for companies to operationalize who have intra-segment transactions between foreign and domestic entities within the same reporting segment. For example, if one entity sells a perpetual software license to another entity within the same segment, the selling entity records the intra-entity sale upfront, while the purchasing entity records the corresponding intra-entity expense over time through the capitalization of the software. In this fact pattern, a common method to operationalize the consolidation process is to record matching revenue and expense entries within the reporting segment. The proposed amendment would necessitate both entities within the consolidating group to present a transaction that previously has not been accounted for or disclosed on a standalone basis under U.S. GAAP and force a new process and entries for elimination.

Usefulness of Information

In addition to the operational challenges this amendment may create, we challenge the consistent usefulness of this information. First, we believe requiring the disclosure to be before intra-entity eliminations would be confusing to the financial statement user because, other than segment reporting in certain circumstances, disclosures in the financial statements are after eliminations. The proposed disclosure would create additional segment-like disclosures, but yet not consistent with how management views the business. Additionally, this would create inconsistency between tax disclosures and the rest of the financial statements.

Further, many intra-entity transactions occur within the same jurisdiction, contributing to the potential confusion and usefulness of the information. For example, disclosing income (or loss) from continuing operations before intra-entity eliminations could obscure external foreign growth and earnings and therefore mislead investors on consolidated foreign results. Under the proposed amendments, an entity with both internal and external foreign operations may report total foreign earnings growth within the income tax disclosures. Meanwhile external foreign earnings may have declined. Investors may mistakenly believe the entity's external foreign business is growing, when in fact the growth is related to intercompany transactions. If the entity's segment information is reported geographically, then users would have access to the actual consolidated foreign results, however the inconsistency with the income tax footnote could create confusion.

We also believe there would be diversity of practice as to defining "before intra-entity eliminations" and could result in numbers potentially not tying to the face of the financial statements. While the Board has acknowledged that these amounts may not reconcile, we emphasize our concerns that this may not be useful or understandable to users.

If the objective of the disclosure is to help investors predict information about related future tax cash flows by jurisdiction, we believe the effect of foreign pretax income and foreign tax rates applicable to such income is already disclosed within the effective tax rate reconciliation. To the extent intra-entity tax arrangements have a material effect on current or future tax rates, public entities should be disclosing that fact within the MD&A. Thus, we don't believe this amendment is necessary or useful to financial statement users.

Additionally, we understand this proposal is intended to present the income (or loss) that is most directly related to the income tax expense (or benefit), which is presumed to be the income (or loss) before intra-entity eliminations. However, many companies have intra-entity transactions that are non-taxable events. For example, to the extent companies with multi-tiered corporate structures make non-taxable distributions from one subsidiary to another, disclosing pretax income (or loss) before intra-entity eliminations would present inflated income because of those distributions and would be misleading to the reader. Therefore, presenting income (or loss) before intra-entity eliminations would not achieve this objective. Thus, it is unclear how removing those transactions for presentation purposes of this disclosure meets the intended objective of the amendment.

For these reasons, and because of the additional work and cost that would be necessary for many entities to adopt this amendment, we recommend that the FASB not specify whether companies should disclose income (or loss) from continuing operations before or after intra-entity eliminations. Instead, we recommend the Board allow such presentation as an optional policy election with clear disclosure by companies of the method used.

Questions 5: Would a proposed amendment to require disaggregation of income tax expense (or benefit) from continuing operations by major tax jurisdiction be operable? Would such a proposed amendment result in decision-useful information about income taxes? Why or why not?

Currently, the SEC requires the disaggregation of income tax expense (or benefit) between federal and foreign taxes in the income tax footnote. Consistent with comments above, we support the FASB's efforts to align its disclosure requirements with the SEC's rules. Additionally, we agree with the Board's decision to not include in this Revised Exposure Draft a requirement to further disaggregate foreign amounts by country, we believe that this requirement would be difficult to operationalize, and the complexity of this information may limit its decision usefulness and could be misleading. Given the SEC's current related disclosure requirements, we do not have concerns about the operability of this level of disaggregation (federal and foreign), as it is already in place (we do, however, have concerns about further disaggregation by state as described below). To help public business entities that must follow both FASB and SEC guidance, we recommend the Board consider leveraging the rule as described by the SEC in order to eliminate any disparity between the FASB and SEC by citing a reference to the SEC's current disclosure requirement to disaggregate income tax expense (or benefit) between federal and foreign taxes rather than creating additional language within the Codification. This referencing would create an efficient method of ensuring alignment on an ongoing basis, should the requirement change. If this referencing were to be included, the FASB may also need to consider an appropriate method of indicating that, even though the specific requirement is an SEC rule, it is also applicable to other than public business entities when indicated in the Codification. We also suggest that the Board consider a similar approach across all Topics that overlap with SEC regulations as they continue their efforts to align U.S. GAAP with SEC regulations and further enhance simplification.

As mentioned above, we have concerns about the proposed incremental requirement to further disaggregate income tax expense (or benefit) at the state level without considering materiality. It is unclear to us why requiring additional disaggregation at the state level is necessary, particularly when the rate reconciliation already includes any material effects of differing tax rates in state jurisdictions. Also, the SEC rules require disclosure if the component is greater than 5 percent of the total. While some companies already present disaggregated amounts that include a total amount for state taxes, this requirement may be a significant undertaking for others to operationalize. For example, for large multinational companies with significant operations and number of tax-paying companies across the United States, but that are not material, this requirement could be burdensome and costly, as many of these companies have nonintegrated subsidiaries and decentralized operations. Further, companies report external financial information on a segment or business measurement basis. In many cases there is a roll-up to the segment or business level that can include all geographies within the segment/business. The same can be true on a sub-segment basis. Thus, to determine the total tax expense for geography, it is necessary to collect information from multiple sub-segments, aggregate, sort, and review that information to determine which jurisdictions require separate disclosure. This process can vary from period-to-period as income changes and/or there are losses that affect which jurisdictions are significant. Gathering detail at this level may require significant and expensive system and process changes and may not be feasible due to the limited reporting timeframe.

We suggest that companies should continue to have discretion on what makes the most sense to present based on their specific facts and circumstances. Therefore, we recommend that the FASB maintain alignment with the SEC and revise its proposed requirements such that companies are required to disaggregate income tax expense between federal and foreign only, leaving companies the ability to adopt a policy election to present state taxes separately.

Question 6: The proposed amendments would modify the existing rate reconciliation requirement for public business entities to be consistent with SEC Regulation S-X 210.4-08(h). 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. Should the Board consider a threshold that is different than 5 percent? If so, please recommend a different threshold and give the basis for your recommendation.

We support the FASB's efforts to align its existing disclosure requirements on the rate reconciliation with SEC Regulation S-X 210.4-08(h) and are supportive of the 5 percent threshold. We believe this consistency is important to improving the overall effectiveness of disclosures and efficiency of their preparation. As mentioned previously, we suggest the Board consider citing a reference to the SEC guidance rather than creating additional language within the Codification.

While we support the consistency of incorporating the 5 percent threshold, we do not agree with the proposed amendment that would deviate from Regulation S-X 210.4-08(h), requiring an explanation of the year-to-year change of each reconciling item. We believe the descriptors that are already included in the rate reconciliation are generally straightforward enough to provide insight into the nature of the items and possible sources for change. Additionally, as part of an entity's MD&A, the SEC expects inclusion of certain disclosures related to income taxes, including a narrative discussion that details what drove a material change in the effective tax rate. Thus, material changes in the rate reconciliation should already be described in the MD&A.

Finally, other Topics within U.S. GAAP do not include similar requirements to discuss variances of this nature within the respective footnotes. Thus, it is unclear why such a deviation would be warranted in this area, particularly given the other referenced source of relevant information.

Question 7: Are there any other disclosures that should be required by Topic 740 on the basis of the concepts in Chapter 8 of Concepts Statement 8, as a result of the Tax Cuts and Jobs Act, or for other reasons? Please explain why. / Question 8: Are there any disclosure requirements that should be removed on the basis of the concepts in Chapter 8, as a result of the Tax Cuts and Jobs Act, or for other reasons? Please explain why.

We appreciate the FASB's efforts and due diligence to carefully analyze the effects of the Tax Cuts and Jobs Act (TCJA) in the context of this existing project. We believe the FASB properly considered the TCJA's impact on income tax disclosures and agree with the Board's conclusion that there is no need to add or remove disclosures due to the TCJA.

Question 9: The proposed amendments would replace the term public entity in Topic 740 with the term public business entity as defined in the Master Glossary 5 of the Codification. Do you agree with the change in scope? If not, please describe why.

We agree with the proposed change in scope to replace public entity with public business entity given the consistency this change creates with recent standard setting within other Topics.

Question 10: Should the proposed disclosures be required only for the reporting year in which the requirements are effective and thereafter or should prior periods be restated in the year in which the requirements are effective? Please explain why.

We believe that the current income tax framework appropriately meets the needs of users and the additional proposed disclosures create significant costs, while compromising simplification and effectiveness. However, if there is an update to the framework, we support the Board's decision that the proposed disclosures should be required only for the reporting year beginning with the effective date of the changes. Those companies most impacted by the amendments will need adequate time to prepare for the effort to obtain information that may not be readily available before the establishment of data collection systems and implementation of new processes. This effort could be significantly compounded if retrospective application were required. Therefore, allowing companies to address the changes on a prospective basis will significantly increase the operability of the amendments.

Question 11: How much time would be needed to implement the proposed amendments? Should the amount of time needed to implement the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities? Should early adoption be permitted? Please explain why.

We believe that the current income tax framework is appropriate and does not need to be updated. However, to the extent any changes to the disclosure framework are adopted, we recommend the proposed update should be effective no earlier than two years after finalization of the disclosure changes. For some companies, the proposed disclosures could require a large amount of additional information that may not be centrally available, and companies may be required to implement additional processes and new systems, or systems upgrades. If the two-year period is adopted, we do not anticipate a need for a different date for entities other than public business entities. We recommend that early adoption should be permitted, as companies are generally free to provide additional disclosure, thus particular elements may be included by entities as they determine them to be useful for financial statement users.

Conclusion

Overall, CCR and COT support the Board's effort to reevaluate the current disclosure framework with the goal of making disclosures more effective. As part of this effort, we also support the Board's work to build more consistency with SEC rules. We believe that an important aspect of this effort is creating clear communication that is focused on material useful information that is quantitatively and/or qualitatively of greatest importance to users. The recommendations outlined in this letter may help further emphasize the most material and most meaningful information within the income taxes footnote, while also addressing our concerns about the operability of certain amendments as proposed. We stand ready to assist the FASB in this effort.

Sincerely,

Mick Homan

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