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To the Point

FASB — final guidance

FASB issues final guidance to simplify one aspect of income tax accounting

The guidance requires companies to classify all deferred tax assets and liabilities as noncurrent on the balance sheet.

What you need to know

- The FASB issued final guidance that requires companies to classify all deferred tax assets and liabilities as noncurrent on the balance sheet instead of separating deferred taxes into current and noncurrent amounts.
- Because early adoption is permitted, companies can start applying this guidance in interim and annual financial statements that have not yet been issued.
- The FASB staff is performing additional research on a companion proposal that would eliminate the current exception that requires companies to defer the income tax effects of certain intercompany transactions.

Overview

The Financial Accounting Standards Board (FASB or Board) issued final guidance[1] that requires companies to classify all deferred tax assets and liabilities as noncurrent on the balance sheet instead of separating deferred taxes into current and noncurrent amounts. Because early adoption is permitted, companies can start applying this guidance in interim and annual financial statements that have not yet been issued.

The FASB staff is performing additional research on a companion proposal to require companies to immediately recognize income tax expenses or benefits on intercompany transactions. The Board asked the staff in October to research the costs and benefits of deferring the income tax effects only for intercompany inventory transactions.

The project is part of the FASB's broader simplification initiative to address narrow topics relatively quickly to reduce the cost and complexity of financial reporting while improving or maintaining the usefulness of information provided to users of financial statements.

Building a better working world

Key considerations

Companies that present classified balance sheets currently are required to classify deferred tax assets and liabilities as current or noncurrent, based on how the related assets or liabilities are classified.[2] If a deferred tax asset or liability is not related to an asset or liability for financial reporting purposes (e.g., a deferred tax asset related to a net operating loss carryforward), the deferred tax asset or liability is classified as current or noncurrent based on the expected reversal date of the associated temporary difference.[3]

Under the new guidance, companies are required to classify all deferred tax assets and liabilities as noncurrent. In addition, companies will no longer allocate valuation allowances between current and noncurrent deferred tax assets because those allowances also will be classified as noncurrent.

The Board said classifying deferred taxes into current and noncurrent amounts does not provide users of financial statements with useful information because it generally does not reflect when the related temporary difference will reverse and become a taxable or deductible item. The Board acknowledged that classifying all deferred taxes as noncurrent is not pure conceptually. However, the Board said this simplification will reduce cost and complexity without decreasing the usefulness of information provided to users.

How we see it

While the guidance changes the way deferred taxes are classified on the balance sheet, companies are still required to offset deferred tax assets and liabilities for each taxpaying component within a tax jurisdiction.

Effective date and transition

For public business entities, the guidance is effective for financial statements issued for annual periods beginning after 15 December 2016 (i.e., 2017 for a calendar-year company), and interim periods within those annual periods. For all other entities, the guidance is effective for financial statements issued for annual periods beginning after 15 December 2017 (i.e., 2018 for a calendar-year company), and interim periods within annual periods beginning after 15 December 2018. Early adoption is permitted for all companies in any interim or annual period. The guidance may be adopted on either a prospective or retrospective basis.

Companies must disclose in the first interim and annual period of adoption the nature of and reason for the change in accounting principle. If the guidance is adopted on a prospective basis, a company must also disclose that prior periods were not retrospectively adjusted. If the guidance is adopted retrospectively, a company must disclose quantitative information about the effects of the accounting change on prior periods.

Endnotes:

1 Accounting Standards Update 2015-17, *Balance Sheet Classification of Deferred Taxes*.
2 Accounting Standards Codification (ASC) 740-10-45-4.
3 ASC 740-10-45-9.