FASB's New Standard for Classifying Deferred Taxes

An Expedient Solution

By Charles E. Jordan

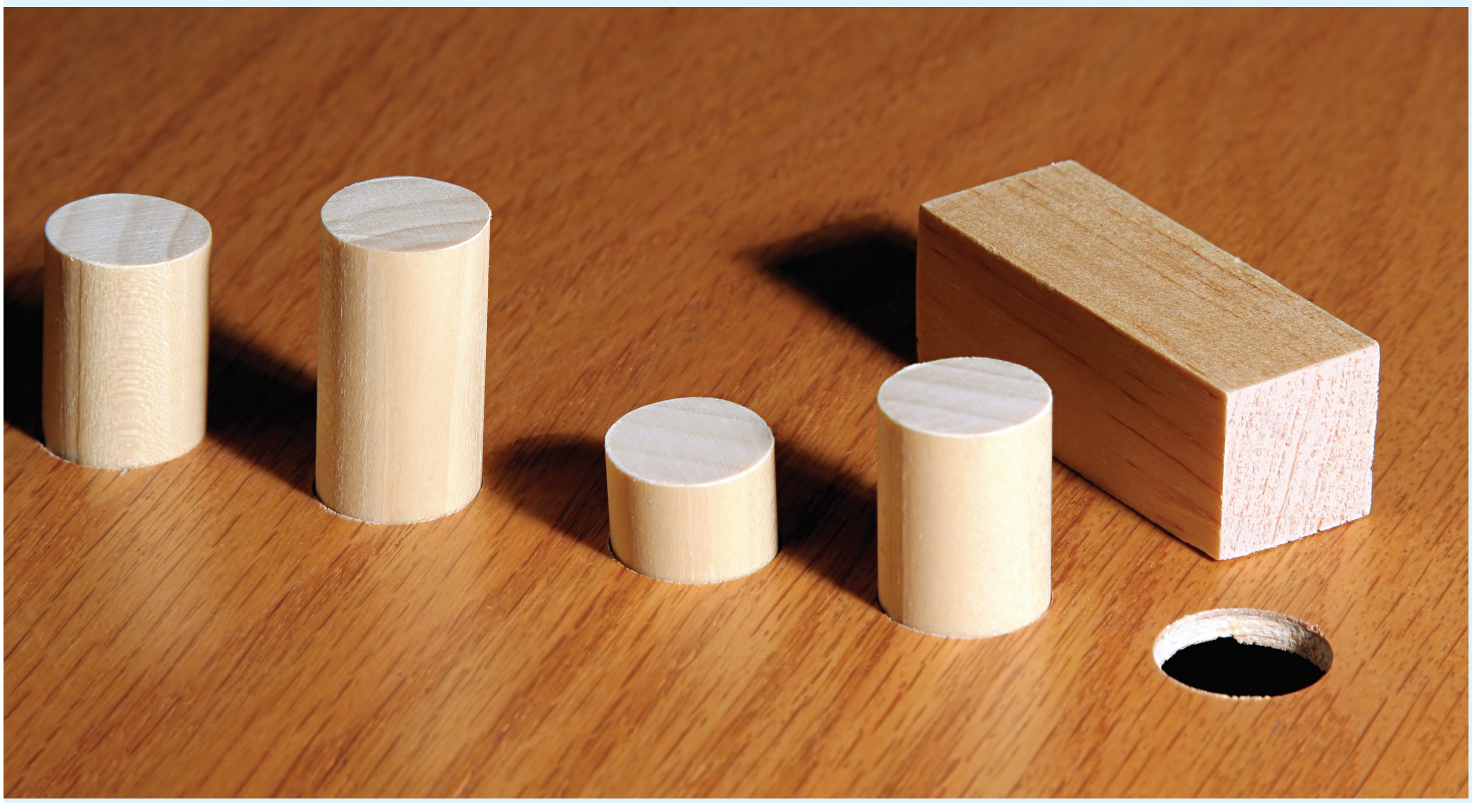
For companies issuing classified balance sheets, current U.S. GAAP requires deferred taxes to be reported in two amounts (i.e., the net current deferred tax asset or liability and the net noncurrent deferred tax asset or liability). Generally, the classification of a deferred tax account as current or noncurrent hinges on the classification of the asset or liability that gave rise to it. Any deferred tax account not arising from a specific asset or liability is classified as current or noncurrent based on its expected reversal date.

On November 20, 2015, FASB issued Accounting Standards Update (ASU) 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes*. Under the ASU, all deferred tax assets and liabilities, as well any valuation allowances, will be netted and presented in a classified balance sheet as one noncurrent amount. ASU 2015-17 becomes effective for public entities for annual periods beginning after December 15, 2016, and for interim periods within those annual periods. For all other entities, the standard becomes effective for annual periods beginning after December 15, 2017, and for interim periods within annual periods beginning after December 15, 2018. The standard's requirements may be applied prospectively or retrospectively to all prior periods presented, and early adoption is allowed. This article explains FASB's reasoning behind the new guidance and argues in favor of its decision.

FASB's Justification for the Change

ASU 2015-17 results largely from FASB's ongoing simplification initiative. The exposure draft for the new standard stated that stakeholders shared FASB's opinion that separating deferred taxes between current and noncurrent amounts resulted in little or no useful information for users but added cost and complexity. The standard will also mesh GAAP with international accounting standards for reporting deferred taxes, which presently require classifying all deferred tax amounts as noncurrent.

The existing standard on deferred taxes [Statement of Financial



Accounting Standards (SFAS) 109, *Accounting for Income Taxes*] states that deferred taxes should be separated between their current and noncurrent portions because classifying them all as noncurrent would be confusing and lead to inappropriate current ratios. FASB changed this stance in the new standard because of its belief that the cost of separating deferred taxes between their current and noncurrent portions outweighs any benefits to financial statement users. In addition, FASB admits in the new standard that classifying all deferred tax accounts as noncurrent is "not conceptually pure," as some deferred taxes are obviously associated with assets and liabilities that will be used up or settled in the upcoming year.

> Separating deferred taxes between current and noncurrent amounts resulted in little or no useful information for users but added cost and complexity.

Evidence Supporting FASB's Decision

The issue boils down to a cost-benefit analysis of separately classifying deferred taxes as current and noncurrent. Quantifying with any degree of accuracy the overall cost to preparers of making this separation or the benefits to users of having this information available would be nearly impossible; however, obtaining a surrogate measure of significance, or lack thereof, is feasible.

The *Exhibit* shows such a calculation. Using data from 2013, the author determined what the current assets, current liabilities, and current ratios would have been for a large sample of U.S. companies if their current deferred tax amounts had been classified as noncurrent. Then, the author conducted tests to ascertain the statistical significance of the difference between these pro forma amounts and the amounts actually reported. The sample includes the 3,611 companies in Compustat's Fundamentals Annual file whose 2013 year-end balance sheets contained at least some amount for deferred taxes. The "as reported" column provides the median amounts presented for current assets and current liabilities, as well as the median current ratio. The "pro forma" column shows the median amounts for these same three variables computed as if any current deferred tax amounts reported had been classified as noncurrent.

Even though the new standard could have materially affected the current assets, liabilities, and ratios for individual companies, the overall effect appears slight. In particular, the differences between the medians for each variable are statistically insignificant. Thus, the results of the present study support FASB's stance, as, at least for 2013, the overall financial statement effects of implementing the new standard would have been largely insignificant and likely to have only minimally affected users' decisions. ❑

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EXHIBIT
Summary Statistics for Current Assets and Liabilities

	As Reported	Pro Forma	Chi-square	P-level
Median Current Assets	$361.00	$352.21	.293	.588
Median Current Liabilities	$190.22	$188.00	.005	.944
Median Current Ratio (CA/CL)	1.827	1.788	1.80	.180

Figures in millions of dollars.

Note: Chi-square statistic and P-level are for a Mood's median test evaluating the statistical significance of the difference between the "as reported" and "pro forma" medians.