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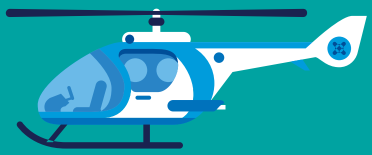

Defining Issues®

SEC staff comments on accounting for tax reform and implementation efforts for new standards

June 27, 2018

KPMG reports on the SEC staff's observations[1] about the progress on accounting for tax reform and implementation of the revenue, leases and credit losses standards.

Applicability

All SEC registrants affected by accounting changes related to:

— HR 1, originally called the Tax Cuts and Jobs Act;[2] and
— ASC 606, *Revenue from Contracts with Customers*; ASC 842, *Leases*; ASC 326, *Financial Instruments – Credit Losses*; and other recently issued accounting standards.

Key facts and impacts

In a recent speech SEC Deputy Chief Accountant Sagar Teotia made several observations related to the SEC staff's expectations about companies' progress on accounting for the effect of the tax reform law and the implementation of new accounting standards.

He reminded registrants that the SEC's Office of the Chief Accountant (OCA) is available to assist registrants on implementation matters through formal or informal consultations. Registrants and their stakeholders should consider the staff observations and thoughtfully evaluate their own progress on implementation.

Tax reform

— SAB 118[3] provides time for a registrant to obtain, prepare and analyze the information necessary to complete the US GAAP income tax accounting[4] requirements related to a change in the tax law.
— SAB 118 does not give the option to defer the accounting requirements until the end of the period.
— A registrant should make good faith progress to provide investors with timely, decision-useful information.
— The disclosure guidance in SAB 118 should not be overlooked.

Implementation requirements

High quality implementation takes time to:

— identify accounting questions;
— make reasonable judgments where necessary; and
— implement effective internal controls related to implementation and ongoing application.

[1] Progress is Being Made: Continued Focus on Addressing Implementation Matters, Sagar Teotia, SEC Deputy Chief Accountant, June 7, 2018

[2] H.R. 1, An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018

[3] SEC Staff Accounting Bulletin 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act

[4] ASC 740, Income Taxes

Tax reform - SAB 118

On December 22, 2017 the United States enacted the biggest overhaul of its tax law in over 30 years, leaving companies only a short time to analyze and recognize the effects of the new law. In response to the challenge posed by this timing, the SEC issued SAB 118, which allows a registrant to recognize provisional amounts when it does not have the necessary information available, prepared or analyzed to complete its accounting requirements.

SAB 118 provides a measurement period (similar to the accounting for business combinations) during which adjustments for the effects of tax reform should be recorded to the extent a reasonable estimate can be made. If all of the information is not available, a registrant should recognize provisional amounts. However, it would not be appropriate to exclude a reasonable estimate from financial statements if one has been determined.

Not a deferral option

However, SAB 118 does not allow a registrant to defer the accounting for the tax law until the end of the period. Instead, SAB 118 requires a registrant to make good faith efforts to determine a reasonable estimate of the law's effect, and complete the accounting in subsequent interim periods for amounts initially recognized and disclosed as provisional.

The measurement period ends when a registrant has obtained, prepared and analyzed the information necessary to finalize its accounting, but cannot extend beyond one year. Information related to the effect of tax reform should be obtained, prepared and analyzed in a timely manner to ensure that investors receive decision-useful information.

The measurement period should not be viewed as a one-year period that would allow any subsequent accounting revisions to be considered changes in estimates without any evaluation. Any subsequent information identified should be evaluated under accounting guidance related to accounting changes and error corrections.[5]

SAB 118 categorizes the accounting for the effect of the tax reform into three categories. A registrant should make a good faith effort to make a reasonable estimate (moving from Category 3 to Category 2) and completing the accounting as quickly as possible (moving to Category 1).

Category	Accounting for the effects of tax reform
Category 1	Complete because the effects are known
Category 2	Reasonable estimate **can** be made
Category 3	Reasonable estimate **cannot** be made

Disclosures

A key component of SAB 118 is the disclosure guidance. These disclosures provide important information to financial statement users about the effect of tax reform, especially in areas in which the accounting is incomplete. The SEC will continue to monitor these disclosures.

Implementation of new accounting standards

The recent adoption of the revenue standard has demonstrated the importance of timely efforts and strong internal controls over financial reporting to implement standards effectively. With the effective dates for the leases and credit losses standards moving onto the radar of many companies, the SEC staff commented on the importance of a few key implementation areas.

Internal controls over financial reporting

When implementing new accounting standards, companies need adequate time to identify accounting questions, make reasonable judgments, and implement effective internal controls.

Evaluating and implementing changes to internal controls concurrently with the evaluation and implementation of a new standard often proves to be the most efficient and effective approach.

[5] ASC 250, Accounting Changes and Error Corrections

Strong internal controls over the initial judgments and estimates made while implementing the standards at transition are vital to ensure an effective adoption.

Disclosures

The SEC staff continues to reiterate the importance of SAB 74[6] and ongoing disclosures as registrants implement new accounting standards. The SEC staff expects SAB 74 disclosures to be increasingly informative in subsequent periodic filings as implementation efforts progress.

Each new accounting standard requires new disclosures. Companies should dedicate sufficient time and resources to prepare these disclosures and implement effective internal controls over them.

Reasonable judgments

The SEC staff will continue to accept well reasoned and thoughtful judgments when registrants apply the new accounting standards. This approach has been demonstrated through consultations with a significant number of registrants during their adoption of the revenue standard. However, well reasoned judgments take time to develop, and it is important that companies gather the relevant facts and consider all accounting alternatives before reaching conclusions.

Audit committee responsibilities

The audit committee has an important role to play in the implementation of new accounting standards. The audit committee sets the right tone at the top, which is a key aspect of the audit committee's oversight of management's efforts and the external audit process. The audit committee should actively participate in the implementation process and understand management's plans to assess the quality and progress of its implementation efforts.

KPMG observation – Revenue	
The recent adoption of the revenue standard by many companies has demonstrated the effort required to implement comprehensive accounting change. The experiences of preparers, industry groups and accounting firms provide insight on many application issues.	However, these issues cannot be evaluated and analyzed until they have been identified. Therefore, it is essential to make meaningful progress on the implementation efforts for the leases and credit losses standards to allow sufficient time to resolve issues that are identified.

KPMG observation – Leases	
While many companies have already shifted their focus and resources to the leases standard, continuing this momentum is critical to an effective implementation. We have observed, consistent with the SEC staff's observations, that the identification of arrangements that include leases subject to ASC 842 can require significant time and resources.	The development of a thoughtful and complete process to identify this population should be underway to allow sufficient time for the subsequent steps needed to apply the leases standard. Identifying and resolving potential application issues or questions also will require extensive time and effort in many cases.

6 Codified in SAB Topic 11.M, Disclosure Of The Impact That Recently Issued Accounting Standards Will Have On The Financial Statements Of The Registrant When Adopted In A Future Period, (commonly referred to as SAB 74).

KPMG observation – Credit losses	
Much of the focus on implementing the credit losses standard has been directed at banks and other financial institutions because they may have more complex and challenging implementation issues. These companies should be diligent in their efforts to identify interpretive questions early, and consider raising them at the FASB's Transition Resource Group for Credit Losses or other available forums.	The SEC staff said that it has had increased consultations this year related to the standard and reminded registrants of its open-door policy to discuss these issues. However, **all companies** should spend the necessary time to understand the potential effects of the new standard to ensure that they allocate appropriate resources for a successful implementation.

Effective dates and implementation resources

Tax reform	Key dates
Tax Cuts and Jobs Act	Enactment date – December 22, 2017
ASC 740	Requires effects of tax law changes to be recognized in the period of enactment (i.e. periods including December 22, 2017).
SAB 118	Allows registrants to recognize provisional amounts during a measurement period. The measurement period ends when a registrant has obtained, prepared and analyzed the information necessary to finalize its accounting, but cannot extend beyond one year (i.e. periods including December 22, 2018).
KPMG implementation resources	Handbook: Accounting for Income Taxes Supplement to Handbook: Tax Reform KPMG Report on New Tax Law

Revenue	Public business and certain other entities[7]	All other entities[8]
Annual periods – Fiscal years beginning after	December 15, 2017	December 15, 2018
Interim periods – In fiscal years beginning after	December 15, 2017	December 15, 2019
Early adoption allowed?	Yes, for fiscal years beginning after December 15, 2016, including the interim reporting periods within that annual reporting period.	

[7] Certain other entities include (1) not-for-profit entities that have issued, or are conduit bond obligors for securities that are traded, listed or quoted on an exchange or an over-the-counter market and (2) employee benefit plans that file financial statements with the SEC.

[8] All other entities may also choose to early adopt in interim reporting periods within the annual period subsequent to initial application.

Revenue	Public business and certain other entities	All other entities
KPMG implementation resources	Handbook, Revenue Recognition Issues In-Depth, Illustrative Disclosures - Revenue KPMG Executive View, ASC 606 implementation – don't forget internal controls and disclosures Industry supplements - See the Latest Revenue News and Views on Financial Reporting Network	

Leases	Public business and certain other entities[9]	All other entities
Annual periods – Fiscal years beginning after	December 15, 2018	December 15, 2019
Interim periods – In fiscal years beginning after	December 15, 2018	December 15, 2020
Early adoption allowed?	Yes, immediately	
KPMG implementation resources	Handbook: Leases Defining Issues, FASB approves new transition method and lessor practical expedient for leases standard Financial Reporting View, Leases KPMG Executive View: ASC 842, Leases – Transition disclosures	

[9] Certain other entities include (1) not-for-profit entities that have issued, or are conduit bond obligors for securities that are traded, listed or quoted on an exchange or an over-the-counter market and (2) employee benefit plans that file financial statements with the SEC.

Credit losses	Public business entities that are SEC filers[10]	All other entities
Annual periods – Fiscal years beginning after	December 15, 2019	December 15, 2020
Interim periods – In fiscal years beginning after	December 15, 2019	December 15, 2020[11]
Early adoption allowed?	Yes, immediately	
KPMG implementation resources	Handbook: Credit Impairment	

[10] An SEC filer is an entity that is required to file or furnish its financial statements with either (a) the SEC or (b) with respect to an entity subject to Section 12(i) of the Securities Exchange Act of 1934, as amended, the appropriate agency under that Section. Financial statements for other non-SEC filers whose financial statements are included with another filer's SEC submission are not included in this definition.

[11] For nonpublic business entities, including not-for-profit entities, and employee benefit plans within the scope of ASC 960, Defined Benefit Plans; ASC 962, Defined Contribution Pension Plans; and ASC 965, Health and Welfare Benefit Plans; the standard is effective for annual periods in fiscal years beginning after December 15, 2020 and interim periods in fiscal years beginning after December 15, 2021.

Contributing authors
Jeff Jones; Rob Werling

KPMG's Financial Reporting View
kpmg.com/us/frv

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