KPMG

Q2 2018 focus: Financial reporting and auditing update

Board Perspectives

Calendar year-end public companies have already cleared the hurdle of adopting the revenue recognition standard and the financial instruments recognition and measurement standard. However, the expanded revenue disclosures required throughout the year of adoption mean continued obstacles lie ahead.

The U.S. tax reform, enacted in 2017, also continues to significantly affect companies' accounting for and reporting of income taxes and their related processes and controls. With the effective date of the leases standard quickly approaching, the FASB is working to finalize technical corrections and amendments so companies can focus on implementing the final standard. These, as well other accounting and financial reporting developments potentially affecting you in the current period or in the months ahead, are summarized below. For more detail about these and other issues, see KPMG's *Quarterly Outlook*.

Current quarter financial reporting matters

U.S. Tax Reform. H.R. 1, originally known as the Tax Cuts and Jobs Act, was enacted on December 22, 2017 and is significantly affecting companies' accounting for and reporting of income taxes and their related processes and controls.

With most of the law's provisions effective January 1, 2018, companies are continuing to refine their estimates of how the law affects their annual effective tax rates. This process includes evaluating whether expenses that were historically deductible before January 1 remain deductible, applying the new rate provisions of the law, determining the effects of the new interest expense limitations, and forecasting whether they will be subject to new taxes on foreign earnings and payments.

Many companies also are continuing to assess the tax effects resulting from adopting the revenue recognition standard and how the adoption interacts with the new tax law, Section 451. Section 451 generally requires accrual method taxpayers to conform their taxable income recognition policies to their financial reporting revenue recognition policies, which may significantly affect how companies identify current and deferred tax amounts.

Treasury also continues to issue tax technical guidance so companies are continuously evaluating the effect of that guidance on their 2018 financial statements. Further, as companies obtain, prepare, or analyze additional information about facts and circumstances that existed at the enactment date, they continue to adjust balances that were recorded provisionally as of December 31, 2017 under SAB 118. Companies are reminded to update their disclosures about provisional balances, as described in the SAB.

Observations on the effects of adopting the revenue recognition standard. First quarter 2018 transition disclosures have been informative about trends in adoption methods and other disclosure matters.

- **Adoption method insights.** Company filings show that the majority of adopters are transitioning using the cumulative-effect method. A company adopting the standard using the cumulative-effect method does not revise its historical financial statements. However, to inform investors about the effects of adoption, the cumulative-effect adopter will, in effect, need to maintain dual reporting to comply with the transition disclosure requirements in the year of adoption. Those companies will need to implement new (or redesign existing) processes and controls to track two accounting methods during the year of adoption to disclose:

  - The amount by which applying ASC 606 affects each financial statement line item in the current period
  - The amount and reason for the significant changes between the reported results under ASC 606 and those that would have been reported under legacy U.S. GAAP.

- **Management's discussion and analysis (MD&A) disclosures.** In addition to the required transition disclosures, many companies are providing additional information in MD&A about the effect of the adoption on prior periods. This presentation is considered a supplemental presentation—not non-GAAP or pro forma financial information.
- **Control changes with implementation**. Companies that have materially changed their internal controls over financial reporting are required to disclose the change in interim and annual filings. Though not required, a number of companies have disclosed the effect of adoption on processes and controls even when management didn't believe those changes were material. When considering whether to disclose internal control changes, it may be helpful to think about the controls associated with adoption in two groups: "onetime" controls put in place to adopt and transition to the new standard and "ongoing" controls needed to account for current and future transactions under ASC 606.

New standards and guidance

Leases standard effective date draws near. The leases standard will be effective for public companies in 2019, and companies are beginning to identify more detailed implementation issues. Public companies have raised questions about the accounting for real estate sale-leaseback transactions that take place before they adopt the leases standard but after they adopt the new revenue standard and about how to apply the optional, short-term lease exemption. They also have questions about whether it is appropriate to use a recognition threshold below which they would not recognize their lease assets and liabilities.

Implementing the credit impairment standard. The FASB's new credit impairment standard will be effective in 2020 for public companies with calendar year-ends. Companies should be analyzing the implications of adopting this standard and considering the adequacy of their disclosures about the expected effects of implementation. Even if a company has not quantified the effects of a new standard, the SEC staff still expects companies to qualitatively describe the expected effects, including how the new policies will compare with current policies.

SEC developments

SEC addresses disclosures about cybersecurity.The SEC has issued interpretive guidance addressing public companies' disclosure obligations under existing law for cybersecurity risk and incidents. It stresses the importance of maintaining comprehensive policies, including disclosure controls and procedures, about cybersecurity risks and incidents. The guidance also reminds registrants about broader prohibitions against insider trading and making selective disclosures about cybersecurity risks or incidents. The guidance became effective on February 26, 2018.

In April, the Center for Audit Quality (CAQ) released a tool that helps board members in their oversight of enterprise-wide cybersecurity risk management. The tool provides sample questions for discussion with management and auditors about cybersecurity risks and disclosures. It also includes a list of resources on cybersecurity from the CAQ, AICPA, and others.

SEC staff issues additional guidance about non-GAAP financial measurers. In April, the SEC's Division of Corporation Finance issued two Compliance and Disclosure Interpretations that clarify when forecasted information provided to board members or other parties in connection with a business combination is excluded from the definition of non-GAAP financial measures.

In March, the CAQ issued guidance to assist audit committees in advancing their oversight of a company's non-GAAP measures. The guidance addresses key matters to consider, including whether the non-GAAP measures present a fair and balanced view of the company's performance. A companion video includes interviews with audit committee chairs discussing real-life examples of how audit committees are thinking about their oversight role.

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