Q3 2018 focus: Financial reporting and auditing update

Board perspectives

The 2019 effective date of the leases standard for public companies is almost here. Companies are focused on understanding the implications of the FASB's recently issued accounting technical corrections and amendments. Soon, they will need to shift their focus to aspects of adoption beyond the technical accounting, including internal controls over financial reporting and disclosures.

Meanwhile, the FASB's work on other standard-setting projects to simplify and clarify current accounting guidance continues. These and 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

Reporting under the revenue recognition standard. With calendar year-end public companies now reporting under the new revenue recognition standard, focus has largely shifted from implementation issues to the quality of adoption disclosures and reasonableness of related accounting judgments. The SEC staff has expressed disappointment in the boilerplate nature of disclosures. In particular, staff has said that disclosures do not sufficiently address the significant judgments companies are making about performance obligations, timing of revenue recognition, licensing arrangements, and "gross versus net" presentation. Also, for some companies, implementation of the standard involved a manual approach, combining manual processes with enabling technology and tools. Audit committees will want to help ensure that these manual work-arounds don't become permanent, and that the work-arounds are automated as soon as possible.

SAB adjustments related to tax reform law. Since the SEC staff issuance of SAB 118, many companies have been recognizing provisional income tax amounts for the effects of the 2017 tax reform law, and continue to adjust balances that were recorded provisionally as of December 31, 2017. Because the SAB 118 measurement period for provisional amounts cannot extend beyond one year—the provisional amounts must be finalized by calendar year-end companies by December 31, 2018.

New standards and guidance

Leases standard effective date draws near. The 2019 effective date for the leases standard is almost here. Companies are currently focused on understanding the implications of the FASB's recently issued accounting technical corrections and amendments. However, they will soon need to shift their focus to the broader aspects of adoption, including internal control over financial reporting and disclosures. Of course, the SEC staff continues to closely monitor SAB 74 transition disclosures for the leases standard. These disclosures should be a key area of focus for audit committees in connection with their company's third quarter 10-Q and 2018 10-K.

Implementing the credit impairment standard. The FASB's credit impairment standard will be effective in 2020 for public companies. Companies should be analyzing the implications of adopting this standard and considering the adequacy of their transition disclosures about the expected effects of adoption. Although the standard is not effective until 2020, those companies that will be most affected by its requirements should be making significant progress toward adoption. The nature and extent of preparations will vary, but companies will need to thoroughly evaluate the effect of the standard and determine what changes will be necessary. Companies may need to collect more data, and significantly change their systems, processes and internal controls to comply with the standard.

Expanding the audit report to include critical audit matters or CAMs. In June 2017, the PCAOB adopted a new auditing standard to make the auditor's report more informative, by (among other things) expanding the audit opinion to include a discussion of the critical audit matters (CAMs) that arose during the audit. The description of CAMs is intended to provide information about audit areas that were especially challenging, subjective, or required complex judgment, and to explain how the auditors addressed these issues. The CAM requirements will take effect for audits of fiscal years ending on or after June 30, 2019 for large accelerated filers.

It is expected that in most audits, the auditor will identify at least one CAM. However, in the infrequent circumstances that no CAMs are identified, the auditor is required to state that in the auditor's report. Early engagement between the auditor, management and audit committee will be key to successfully implementing the CAM reporting requirement. Management and the audit committee should begin talking now with their auditor about potential CAMs and how their identification and descriptions compare with information currently disclosed by the company. While the standard does not prohibit the auditor from providing original information in its report, it should limit that information to describing the principal considerations in concluding that a matter was a CAM and how it was addressed in the audit.

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