KPMG

Current Developments: US

December 2017

kpmg.com/us/FRV

Current Developments: US

December 2017

The effective date for the revenue recognition standard is here for public companies with calendar year-ends. Companies need to prioritize their revenue implementation projects and engage their audit committees and external auditors when making significant accounting judgements as the new standard is implemented for both the transition disclosures and going forward.

Although companies are rightfully dedicating their attention and resources to implementing the revenue recognition standard, they cannot lose sight of other standards effective in 2018. This includes the recognition and measurement guidance for financial instruments and several other standards intended to clarify or simplify accounting requirements.

Not to be forgotten, the leases standard looms one year later. Companies should begin their implementation efforts now to reduce surprises and increase implementation quality.

Meanwhile, the SEC staff continues to emphasize to companies the importance of remaining focused on their implementation efforts for all major standards.

Our publication summarizes these and other accounting and financial reporting developments potentially affecting you in the current period or near term.

Contents

1 Current quarter financial reporting matters

2017 AICPA Conference highlights

The AICPA has held its annual Conference on Current SEC and PCAOB Developments, featuring speakers from regulators, standard setters, preparers, auditors and others who discussed recent developments in accounting, auditing and financial reporting.

The main theme of the **new SEC leadership** was supporting the US public capital market by instituting regulatory changes to encourage more IPOs and foreign private issuer registrations while maintaining a high degree of investor protection. To this end, the SEC staff outlined several initiatives designed to streamline the regulatory process.

Significant time was devoted to the **new accounting standards**. With many public business entities about to adopt the revenue recognition standard, the SEC staff is shifting its focus away from transition disclosures to implementation issues. SEC speakers delivered important insights about how the SEC will consider judgments that companies make when applying the revenue recognition standard and, by implication, other standards, such as the leases and credit impairment standards.

In another important shift, the FASB chairman confirmed **the end of an era** by indicating that the Board will not be developing comprehensive new standards in the near term as preparers implement and investors work to understand the revenue recognition, leases and financial instruments standards.

The PCAOB discussed its new standard, which will significantly alter the **composition of the auditor's report**. The enhanced report will feature prominently in a company's SEC filings (see Audit developments affecting financial statement preparers).

Another important theme of the conference was the effect that **emerging technology** will have on the financial reporting process. Many speakers cited examples, including distributed ledger technology and robotic process automation, which are expected to affect how a company gathers and stores transactional information, and how an auditor verifies the existence of that information. Additionally, the cryptocurrencies enabled by these technologies raise a host of accounting and securities laws issues.

These conference topics illustrate the enormous changes occurring in financial reporting. We observe that two fundamental practices are crucial for managing change, no matter the source. The first is **open and robust lines of communication** between the audit committee, management and independent auditor. The second is a **commitment to developing and maintaining appropriate policies, procedures and controls** that are established by management and overseen by the audit committee. These two practices will

be essential as companies manage significant changes on the horizon, including imminent US tax reform.

Resources: KPMG's SEC Issues & Trends, AICPA Conference on Current SEC and PCAOB Developments

SEC headlines

Proposal to change Regulation S-K

The SEC proposed modernizing and simplifying certain disclosure requirements in Regulation S-K and related rules and forms. Key changes would affect Management's Discussion and Analysis; the description of property, exhibits and confidential information; incorporation by reference; and the manner of delivery and tagging of cover page data.

Comments were due January 2, 2018.

Resources: KPMG's Defining Issues, SEC proposes changes to Regulation S-K; Proposed Rule

Simplified capital raising process

Earlier this year, the SEC's Division of Corporation Finance announced that it will permit most companies to submit initial draft registration statements to the SEC for nonpublic review. More recently, the SEC staff clarified what offerings are eligible for nonpublic review.

Eligible for nonpublic review	Not eligible for nonpublic review
— Equity IPOs — Registrations of public debt before an IPO — Resale of privately acquired securities (initial offerings) — Exxon Capital Debt Exchanges on Form S-4 (if before an IPO) — Registration statements under Exchange Act Section 12(b): – Form 10 – Form 20F – Form 40-F	— Proxy statements (and related Forms S-4)[1] — Forms 8-A under Exchange Act Section 12(b) — Registration statements under Exchange Act Section 12(g)

[1] The eligibility to use Form S-4 for a merger transaction depends on the specific facts and circumstances. The SEC staff encourages these issuers to contact the staff to discuss whether a nonpublic review is acceptable based on specific facts and circumstances.

The announcement expands the nonpublic review of registration statements, allows filers to omit certain financial information from draft registration statements, and encourages prospective filers to seek relief from overly burdensome filing requirements.

Resources: KPMG's Issues & Trends, The SEC has made the capital raising process easier for companies; SEC Announcement

SEC staff focus on certain income statement presentation and measures

The SEC staff is commenting on and requiring financial statement revisions for the classification of expenses, allocation of indirect costs and presentation of gross margin for companies to comply with S-X Rule 5-03.2, SAB Topic 11.B and SAB Topic 14.F in their income statements.

Resources: KPMG's SEC Issues & Trends, SEC focuses on income statement presentation and measures excluding certain costs

Interpretive guidance about pay ratio disclosures

The SEC staff has issued guidance to help registrants prepare their 2018 required pay ratio disclosures. The guidance addresses certain interpretive matters, including estimation methodologies, and includes examples of statistical sampling methodologies and other reasonable methods to calculate the pay ratio disclosure.

The pay ratio disclosure rule is mandated by the Dodd-Frank Act and requires registrants to disclose the ratio of the primary executive officer's compensation to the median compensation of all employees. The rule is effective for registrants for fiscal years beginning on or after January 1, 2017.

Resources: KPMG's Defining Issues, SEC adopts interpretive guidance on pay ratio disclosures; SEC Interpretation, Guidance on calculation of pay ratio disclosure and Final Rule

CAQ SEC Regulations Committee meeting

The Center for Audit Quality (CAQ) SEC Regulations Committee met in July 2017 and discussed several reporting matters.

Waivers via Rule 3-13 of Regulation S-X. Rule 3-13 of Regulation S-X gives the SEC staff authority to permit a registrant to omit or substitute for certain financial statements otherwise required by Regulation S-X. Accordingly, the staff added a new section to the Financial Reporting Manual, *Communications with the Division of Corporation Finance's Office of Chief Accountant*, which includes the names of CF-OCA staff members to contact about this relief. The new section indicates the staff is available to discuss potential waiver fact patterns by phone before the registrant submits a written request.

Process for requesting omission of selected financial data. The staff indicated that non-emerging growth company (EGC) domestic registrants asking to omit the earliest two years of selected financial data required by Item 301 of Regulation S-K should contact the staff to discuss how to comply with the requirements.

Regulation A Submissions. The staff shared an overview of trends and statistics in Regulation A filings.

Evaluating significance of a business disposal in connection with a proxy statement soliciting authorization for the disposal. The staff decided not to set a bright-line threshold for evaluating whether proxy statements soliciting authorization for a disposal require financial statements of the business being disposed. Registrants should consult with the staff and their securities counsel if they have questions about whether they need to provide those financial statements.

Pro-forma financial information presented in a Form 8-K for a significant acquisition made after a previously reported significant acquisition. Although Article 11 of Regulation S-X requires that the pro-forma financial information in a 1933 Act filing include the effects of both acquisitions, the instruction for Item 9.01(b)(1) of Form 8-K does not explicitly require including the pro-forma effect of both acquisitions. However, the staff would encourage a registrant to reflect the effect of both acquisitions in the Form 8-K pro forma financial information even though it is not required by Item 9.01(b)(1).

Resources: July 2017 meeting highlights

Updated Mortality Improvement Scale

The Society of Actuaries (SOA) issued the 2017 Mortality Improvement Scale (MP-2017), which accompanies its most recent Mortality Table RP-2014. The updated scale reflects a decrease in the rate of improvement, and may reduce a company's retirement obligation by 0.7 to 1.0 percent compared with an obligation determined using MP-2016. Companies should consider the SOA's new data for US-based defined benefit pension and other post-retirement benefit plans when making their mortality assumptions for year-end 2017 financial reporting.

Resources: MP-2017

FASB amends codified SEC guidance on revenue and leases

- **ASU 2017-13** codifies the SEC announcement providing effective date relief for certain public business entities adopting the new revenue recognition and leases guidance. The standard also rescinds SEC Observer comments about revenue recognition and leases that no longer apply after the adoption of the new standards.

- **ASU 2017-14** addresses guidance previously issued by the SEC.
  - SEC Staff Accounting Bulletin (SAB) No. 116 modifies other SAB Topics to confirm existing SEC staff guidance to the revenue recognition standard. The ASU supersedes various SEC paragraphs and amends an SEC paragraph pursuant to the issuance of SAB 116.
  - SEC Interpretive Release on Vaccines for Federal Government Stockpiles stated that on adoption of the revenue recognition standard, manufacturers should recognize revenue for vaccines when they are placed into the Vaccines for Children Program and Strategic National

Stockpile. The ASU supersedes various SEC paragraphs and adds an SEC paragraph under this guidance.

Resources: KPMG's web article; ASUs 2017-13 and 2017-14

AICPA guidance about PBEs

The AICPA issued a series of Technical Questions and Answers about applying the definition of a public business entity (PBE). The Q&As include guidance about:

- determining whether (a) an instrument is a 'security', (b) a security is traded in an 'over the counter market' and (c) a security has a 'contractual restriction on transfer';
- evaluating the PBE definition at each level in a tiered organizational structure;
- applying the definition to equity method investees and applying the equity method to private investees;
- analyzing issues specific to banks and insurance companies that are subject to regulatory requirements; and
- analyzing the effects of the issuer of security resales under Rules 144 and 144A.

Resources: KPMG's web article; AICPA Technical Q&As – Definition of a PBE

Audit developments affecting financial statement preparers

2017 Audit Committee Transparency Barometer

The Center for Audit Quality (CAQ) and Audit Analytics released its annual report that measures the robustness of proxy disclosures among companies in the S&P Composite 1500. The CAQ's findings confirmed that audit committees have continued to enhance transparency of external audit oversight by voluntarily and broadly increasing disclosure. The report also offers examples of leading disclosure practices that can be tailored to a company's specific facts and circumstances.

Resources: 2017 Audit Committee Transparency Barometer

SEC approves changes to the auditor's reporting model

The SEC recently approved the PCAOB standard that requires significant enhancements to the auditor's report prepared under those standards.

The first phase of the new requirements is effective for auditors' reports for fiscal years ending on or after December 15, 2017. Amendments related to interim review reports are effective for interim periods thereafter (e.g. March 31, 2018 for a calendar year-end company). Phase one enhancements include:

- disclosing auditor tenure (i.e. the year in which the auditor began consecutive service as the company's auditor);
- adding wording to clarify the auditor's responsibility under PCAOB standards to plan and perform the audit to obtain reasonable assurance

about whether the financial statements are free from material misstatement, whether due to error or fraud;
- adding a statement that the auditor is required to be independent; and
- reorganizing the auditor's report so that the opinion will be included in the first paragraph.

The PCAOB published guidance to help audit firms implement the first phase of these changes.

Phase two requires auditors to communicate critical audit matters (CAMs) in the auditor's report. The standard defines CAMs as matters that are required to be or have been communicated to the audit committee; are related to accounts or disclosures that are material to the financial statements; and involve especially challenging, subjective or complex auditor judgment. The requirement to communicate CAMs will be effective for:

- **large accelerated filers**, for audits of fiscal years ending on or after June 30, 2019; and
- **all other companies**, for audits of fiscal years ending on or after December 15, 2020.[2]

Management and audit committees should take advantage of the time before the CAM reporting requirements become effective to discuss the new requirements with their auditors. Early dialogue will be key for effective and timely implementation of this aspect of the new standard.

Resources: KPMG's Defining Issues, PCAOB issues auditing standard to enhance auditors' report; PCAOB standard and PCAOB staff guidance

[2] The communication of CAMs is not required for audits of emerging growth companies; brokers and dealers; investment companies other than business development companies; and employee stock purchase, savings and similar plans.

2017 financial reporting reminders

In the first quarter of 2017, calendar year-end public companies were required to adopt several accounting standards intended to simplify or clarify accounting guidance.

- **Simplifying the measurement of inventory (ASU 2015-11)** changes inventory measurement from 'lower of cost or market' to 'lower of cost and net realizable value'. The guidance applies to only inventory measured using first-in, first-out (FIFO) or average cost.
- **Presentation of deferred taxes as noncurrent (ASU 2015-17)** requires companies to offset all deferred tax assets and liabilities (and valuation allowances) for each tax-paying jurisdiction within each tax-paying component and present the net deferred tax as a single noncurrent amount.
- **Effect of derivative contract novations on existing hedge accounting relationships (ASU 2016-05)** clarifies that a change in one of the parties to a derivative contract (through novation) that is part of a hedge accounting relationship does not, by itself, require de-designation of that relationship if all other hedge accounting criteria continue to be met.

- **Contingent put and call options in debt instruments (ASU 2016-06)** clarifies that determining whether the economic characteristics of a put or call are clearly and closely related to its debt host requires only an assessment of the four-step decision sequence outlined in ASC paragraph 815-15-25-42. Additionally, companies are not required to assess separately whether the contingency itself is clearly and closely related.
- **Simplifying the transition to the equity method of accounting (ASU 2016-07)** eliminates the requirement for an investor to retroactively apply the equity method when its increase in ownership interest (or degree of influence) in an investee triggers equity method accounting.
- **Improvements to employee share-based payment accounting (ASU 2016-09)** simplifies the accounting for share-based payment transactions. Under the new standard, all companies:
  - record all excess tax benefits and tax deficiencies as an income tax benefit or expense in the income statement (i.e. the standard eliminates the APIC pool) and classify excess tax benefits as an operating activity in the statement of cash flows;
  - may elect an accounting policy to either estimate the number of forfeitures (current US GAAP) or account for forfeitures when they occur;
  - can withhold up to the maximum individual statutory tax rate without classifying the awards as a liability; and
  - classify the cash paid to satisfy the statutory income tax withholding obligation as a financing activity in the statement of cash flows.

  The standard also provides additional practical expedients for nonpublic companies.

The Appendix – Accounting standards effective dates provides a complete list of accounting standards that companies need to adopt in 2017 and in the future.

Companies also should consider disclosures about *all* issued but not yet adopted accounting standards (i.e. SAB 74 disclosures) when preparing their 2017 financial statements (see SEC staff observations – Implementing new accounting standards and Other changes for 2018).

2 New standards and guidance

SEC staff observations – Implementing new accounting standards

In a recent speech about accounting change, the SEC staff made several observations about adopting the revenue recognition, leases and credit impairment standards.

- **Now is the time** to make implementation a priority.
- **Internal controls over financial reporting** most likely will change and require time to implement.
- The SEC expects to see increasingly informative **SAB 74 transition disclosures** in the periods before adoption of the standards.
- **New required disclosures** are an important aspect of adoption and may be time consuming.
- The SEC is available for **pre-filing consultations** and will accept reasonable, thoughtful judgments.
- **Audit committees** set the tone for successful implementations and should be actively engaged.

Companies and their stakeholders should consider these observations and thoughtfully evaluate their current and planned efforts for these major standards.

Resources: KPMG's Defining Issues, SEC staff comments on implementation of new accounting standards and SEC Issues & Trends, AICPA Conference on Current SEC and PCAOB Developments; SEC speech

---

Revenue recognition – The final countdown

As the 2018 effective date of the revenue recognition standard looms, companies need to prioritize their implementation efforts. Finalizing accounting conclusions, designing and implementing internal controls and preparing disclosures is consuming more time and resources than companies anticipated. Many public companies may need to accelerate their efforts to identify accounting questions, make reasonable judgments, reach accounting conclusions and implement effective internal controls.

SEC observations

The SEC staff recently made several observations about adopting new accounting standards (see SEC staff observations - Implementing new accounting standards), noting an increase in pre-filing consultations related to the revenue recognition standard. Companies may consult with the SEC staff, either formally or informally, but should be mindful that well-reasoned

judgments take time to develop. Companies that expect to consult with the SEC staff should act as soon as possible.

Additionally, the staff reminded companies that SAB 74 disclosures in fourth quarter 2017 are expected to be more informative to users of financial statements than those in prior quarters. Companies should consider their changes to internal controls and the new required revenue disclosures in their assessment and disclosure of how the adoption of the revenue recognition standard affects them.

PCAOB Staff Audit Practice Alert

In October, the PCAOB published Staff Audit Practice Alert No. 15, *Matters related to auditing revenue from contracts with customers*. The Alert highlights areas of audit risk related to a company's implementation of the revenue recognition standard, including:

- auditing management's transition disclosures in the notes to the financial statements;
- auditing transition adjustments;
- considering internal control over financial reporting;
- identifying and assessing fraud risks;
- evaluating whether revenue is recognized in conformity with the applicable financial reporting framework; and
- evaluating whether the financial statements include the required revenue disclosures.

A sufficient understanding of the standard and the company's contractual arrangements; accounting estimates; and new or updated processes, systems and controls over its implementation of the standard is critical for the auditor to perform quality reviews and audits.

Resources: PCAOB Staff Audit Practice Alert on ASC 606

Effective date nears for FI recognition and measurement guidance

The FASB's standard about recognition and measurement of financial instruments (financial assets and financial liabilities) is effective in 2018 for public companies.

The most significant operational changes likely will relate to the new guidance for investments in equity securities measured at cost because the fair value is not readily determinable. The new standard allows companies to measure these equity securities at fair value, or use a new measurement alternative that requires the investor to adjust the cost basis for impairment and observable transaction prices for identical or similar securities of the same issuer.

If a company elects to measure these investments at fair value, it should ensure that it has appropriate processes and controls in place to estimate the fair value at each reporting date. Companies that elect to apply the new

measurement alternative should ensure that those processes and controls are sufficient to:

- determine which securities of the same issuer are considered to be similar;
- search for observable transactions of identical or similar securities; and
- determine how the transaction price of a similar, but not identical, security should be adjusted to reflect differences in rights and obligations.

The new standard also requires that equity securities that have a readily determinable fair value be measured at fair value with changes recognized in net income. Additionally, the new standard includes guidance for the valuation allowance on deferred tax assets, fair value disclosures and financial liabilities measured using the fair value option.

Targeted clarifications

The FASB proposed targeted clarifications to the recognition and measurement guidance. The most significant changes would:

- clarify the transition requirements for equity securities without a readily determinable fair value. If a company elects to apply the measurement alternative, the transition would be prospective. If it chooses to apply fair value measurement, the transition would be applied through a cumulative-effect adjustment;
- permit companies that initially elected the measurement alternative for equity securities without readily determinable fair values to subsequently elect to measure them at fair value; and
- clarify that when the measurement alternative is applied to forward contracts and purchased options, the entire fair value is remeasured whenever transactions in the underlying equity securities are observed.

The proposed amendments would be effective on adoption of ASU 2016-01.

Resources: KPMG's Q&A, Financial instruments – recognition and measurement; ASU 2016-01

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 adoption.

The FASB's overhaul of credit impairment accounting will significantly affect financial institutions and other companies that originate or invest in financial assets such as loans, receivables and debt securities measured at amortized cost. The new current expected credit loss (CECL) model will require companies to recognize an estimate of credit losses expected to occur over the remaining life of the financial assets, including estimating future economic conditions and the effect those conditions will have on expected credit losses.

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.

FASB update

The FASB discussed unresolved issues from the June Transition Resource Group (TRG) meeting about determining the estimated life of credit card receivables and troubled debt restructurings.

Credit card receivables

The TRG discussed how to allocate expected future payments between the reporting date balance and balances expected to arise after the reporting date. Specifically, the TRG clarified that a company is permitted but not required to apply expected principal payments to credit card receivable balances existing at the reporting date until the balance is exhausted.

Alternatively, a company could choose other methods that allocate expected principal payments between the balance existing at the reporting date and future balances. The TRG noted that different approaches will result in different estimates of expected credit losses.

Some TRG members raised questions about how future principal payment amounts should be determined when a company elects to allocate those payments to the credit card receivables balance existing at the reporting date until it is exhausted. In October, the FASB discussed how to determine estimated expected future payments. Consistent with the flexibility provided in other aspects of measuring expected credit losses, the Board decided that a specific approach would not be required. Instead, a company may:

- include all payments expected to be collected from the borrower;
- include a portion of the payments expected to be collected from the borrower; or
- apply a different approach.

Troubled debt restructurings (TDRs)

In September, the FASB discussed when the effects of TDRs that have not been included in the company's historical loss experience should be included in the allowance for credit losses. The FASB determined that these types of TDRs should be included in the estimate of expected credit losses when a company reasonably expects that a specific financial asset will be modified as a TDR. At that time, all of the effects of the TDR, including the cost of the concession and the effect of extending the contractual term (if applicable), are recognized.

Resources: KPMG's Handbook, Credit impairment; September and October TRG meeting minutes; ASU 2016-13

Hedging standard may be adopted early

In August, the FASB issued a standard that allows companies to better align their hedge accounting and risk management activities, and potentially reduce the cost and complexity of applying hedge accounting. The standard requires companies to change how they recognize and present the effects of hedge accounting by:

- eliminating the requirement to separately measure and report hedge ineffectiveness; and
- requiring companies to present all of the elements of hedge accounting that affect earnings in the same income statement line as the hedged item.

The standard also permits hedge accounting for strategies for which hedge accounting is not permitted today, and includes new alternatives for measuring the hedged item for fair value hedges of interest rate risk. The standard eases the requirements for effectiveness testing, hedge documentation and applying the critical terms match method and introduces new alternatives that will permit companies to reduce the risk of material error corrections if they misapply the shortcut method.

Companies may early adopt the standard, including during an interim period. If adopted at other than the beginning of a fiscal year, the cumulative effect adjustments are reflected as of the beginning of the fiscal year.

Resources: KPMG's Defining Issues, Changes to hedge accounting; ASU 2017-12

Leases – FASB update and implementation issues

The leases standard will be effective for public companies in 2019. Companies that have begun implementing the standard are encountering unexpected transition challenges that should give fair warning to those companies that have not yet started or are behind. A good place to start (or continue) implementation efforts is to focus on the completeness and accuracy of the 'old' lease disclosures (i.e. those required under current US GAAP). Determining the discount rate to be used for lessee operating leases is another priority.

The FASB decided to propose or finalize amendments to the leases standard to address certain implementation issues raised by stakeholders. Specifically, the FASB decided to:

- finalize amendments to the new standard and related guidance about the accounting for land easements;
- propose optional transition relief that would permit companies not to present comparative financial information (including disclosures) in transition to the new standard;
- propose an optional practical expedient that would permit lessors not to separate lease and related non-lease components if separating those components affects presentation and disclosure only; and
- propose technical corrections to the leases guidance.

Update on FASB standard-setting activities

Accounting for land easements[3]

The FASB decided to finalize amendments that will:

- clarify that land easements are in the scope of the new leases standard, and should be accounted for as leases if they meet the definition of a lease under that standard. Companies will account for land easements under other US GAAP only if they do not meet the definition of a lease; and
- codify a practical expedient to permit companies to not assess on transition whether land easements that commence before the effective date of the new leases standard are leases that were not previously accounted for as leases under current US GAAP.

[3] In general, an easement is a right to use and/or enter (or cross) land owned by another party for a specific purpose, for which the rights vary depending on the easement. Easements are used in many industries, but are especially common in the energy, utilities, transportation and telecom industries. Easements may be perpetual or for a defined term, and may be prepaid or paid over time.

Transition relief

The Board tentatively decided to propose an amendment to permit all companies to use the effective date of the new leases standard as their date of initial application in transition. If a company elects this transition option, it would not need to adjust its comparative period financial statements (e.g. its 2017 and 2018 financial statements for a public company with a calendar year-end) for effects of the new standard or make the new required lease disclosures for periods before the effective date. In addition, the company would recognize its cumulative effect transition adjustment (e.g. for the effect of any unamortized initial direct costs that are required to be written-off at transition) as of the effective date rather than the beginning of the earliest comparative period presented in the company's first set of annual financial statements issued under the new standard.

Lessor separation of lease and non-lease components

The Board decided to propose a practical expedient whereby a lessor would be permitted not to separate lease and related non-lease components, and account for them as a single lease component, if (1) doing so would affect only presentation and disclosure in the financial statements and (2) the combined component will be classified as an operating lease. In other words, if the amount or timing of total (lease and non-lease) revenue recognition does not change, and the combined component is an operating lease, a lessor would be permitted to combine lease and related non-lease components and account for them as a single lease component.

This practical expedient would be an accounting policy election and elected by class of underlying asset. A lessor electing this expedient would disclose its election and to which classes of underlying assets it is being applied, and the nature of non-lease components combined with lease components.

Technical corrections

The FASB proposed 16 technical corrections to the new leases guidance based on feedback received from stakeholders. The proposed amendments are narrowly focused and do not change core principles of the new standard.

The FASB will redeliberate the proposed technical corrections before deciding whether to finalize them.

Surprising challenges and unexpected complications

A recent KPMG survey identified several unanticipated transition challenges that companies are facing, including:

- identifying embedded leases;
- selecting and implementing an adequate leasing system;
- gathering and entering data into the leasing system;
- locating lease contracts and applying the lease definition;
- establishing assumptions and inputs (e.g. discount rates, likelihood of exercising options);
- estimating operating costs or service components; and
- reporting on proper accounting treatment and disclosures.

Companies that have made substantive progress toward implementation are finding that it is taking longer to identify and implement the changes than they anticipated. Additionally, most survey respondents have determined that they need new leasing software, and some believe it will take over 12 months to implement new leasing systems or enhancements to existing systems.

Without delay, companies need to establish a project management team to focus on these issues, and to compile their lease inventories and accounting impact assessments. Additionally, in view of the long lead time expected for implementing system changes, companies should begin identifying necessary system requirements and customizing or procuring leasing software.

A fresh look at 'old' lease disclosures

The transition guidance is designed to effectively permit a lessee to use its current US GAAP future operating lease commitments disclosure as a key input to its transition adjustment to recognize those leases on-balance sheet for the first time (i.e. as of the entity's 'date of initial application'). Assuming the disclosure is complete and accurate, the lessee's new operating lease liabilities will reflect a discounted version of the future minimum rental payments included in the company's existing disclosure.

Additionally, some of the new lessee disclosure requirements are broadly consistent with those required under current US GAAP (e.g. requirements to disclose total, fixed and contingent lease expense).

Ensuring the completeness and accuracy of the current year disclosures may pay significant dividends in preparing for the switch to the new standard's accounting and disclosure requirements. Companies also may be able to leverage information included in their current disclosures to help meet their SAB 74 requirements (e.g. to quantify the balance sheet effect).

Enhanced focus on lessee discount rates

Determining an appropriate lessee discount rate becomes more important under the new standard. This is because most leases (other than short-term leases) will be recognized on-balance sheet, and a lessee's discount rate can materially affect the amount of the lease liability and right-of-use asset recognized. Additionally, while the new standard includes familiar terms (e.g. 'rate implicit in the lease' and 'incremental borrowing rate'), there are differences in how a lessee will apply those terms compared with current US GAAP. Lessees will need to consider, among other things, how to ensure their

incremental borrowing rate reflects a collateralized rate, when to use a parent company's incremental borrowing rate for the lease of a subsidiary, and the effects of foreign currency on the incremental borrowing rate.

Some lessees will be able to use a portfolio approach to determine the discount rate for leases with similar characteristics if doing so would not materially affect the accounting for those leases to which the single discount rate is applied. This material effect assessment does not require a quantitative evaluation, but must be supported. Applying a portfolio approach in determining the discount rate may alleviate some of the concerns that entities have about determining (and documenting the basis for) a separate rate for every lease.

As an accounting policy election, nonpublic companies are permitted to use a risk-free discount rate. However, using a risk-free rate will result in higher lease liabilities and right-of-use assets as compared with those measured using a collateralized rate.

Resources: KPMG's Handbook: Leases, Accounting change survey: revenue and leasing, recent webcasts about lease implementation – Part I and Part II, and Defining Issues, FASB agrees to further amend the leases standard

IRS audit rules may affect how partnerships account for tax underpayments

A recent law includes new rules for audits of partnerships that are intended to ease the administrative burden placed on the IRS when it collects underpayments.[4] The law generally allows the IRS to collect underpayments from the partnership versus the current mechanism of pursuing payment from the partners. As a result, certain partnerships may need to change their accounting for tax underpayments beginning in 2018.

Certain qualifying partnerships may elect out of the new rules for a tax year. A partnership that does not (or cannot) elect out for a tax year may file a 'push out election', which requires its partners to report the imputed underpayments on their individual tax returns. The financial reporting effect of the new rules on a partnership that cannot elect out depends on whether the partnership may push the underpayment out to its partners.

Resources: KPMG's Defining Issues, Recent IRS audit rules may affect how partnerships account for tax underpayments

[4] Bipartisan Budget Act of 2015 that takes effect for tax years beginning after December 31, 2017.

Other changes for 2018

In the first quarter of 2018, calendar year-end public companies must adopt not only the new revenue recognition and financial instruments recognition and measurement standards, but also several other standards intended to simplify or clarify accounting requirements.

- **Classification of cash receipts and cash payments (ASU 2016-15)** provides cash flow classification guidance on eight issues.
- **Accounting for income taxes on intercompany transfers (ASU 2016-16)** requires the seller and buyer to recognize at the transaction date the current and deferred income tax consequences of intercompany asset transfers (except transfers of inventory).
- **Restricted cash (ASU 2016-18)** requires companies to include cash (and cash equivalents) that have restrictions on withdrawal or use in total cash (and cash equivalents) on the statement of cash flows. The standard does not define 'restricted cash' or 'restricted cash equivalents', but companies will need to disclose the nature of the restrictions.
- **Clarifying the definition of a business (ASU 2017-01)** provides a new framework for determining whether transactions should be accounted for as acquisitions (or disposals) of a group of assets or a business. An integrated set of activities and assets (a set) is a business if it has, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs. The new framework includes an initial screening test (Step 1) that reduces the population of transactions an entity needs to analyze in determing whether a set includes an input and a substantive process (Step 2).
- **Accounting for the derecognition of nonfinancial assets (ASU 2017-05)** clarifies the guidance in ASC 610-20 about the accounting for the derecognition of a nonfinancial asset and an in-substance nonfinancial asset. Specifically, the guidance in ASC 610-20 will apply only when the asset (or asset group) (1) does not meet the definition of a business (under ASU 2017-01) and (2) is not a not-for-profit entity.
- **Presentation of net periodic pension cost and net periodic postretirement benefit cost (ASU 2017-07)** requires companies to present the service cost component separately from other components of net benefit cost. Specifically, a company will present service cost in the income statement line item in which it reports compensation cost. All other components of net benefit cost will be reported in the income statement separate from the service cost component and outside operating income, if that subtotal is presented. Additionally, the service cost component will be the only component that can be capitalized.
- **Scope of modification accounting (ASU 2017-09)** clarifies when changes to the terms or conditions of a share-based payment award must be accounted for as a modification. Specifically, companies will apply modification accounting unless the fair value, vesting conditions and classification of a modified award are the same before and after the modification.

The Appendix – Accounting standards effective dates provides a complete list of accounting standards that companies need to adopt in the future.

3 Projects and agenda priorities

FASB project on accounting for insurance contracts

In the fourth quarter of 2017, the FASB made significant progress on its proposed accounting standard that would change how insurance entities recognize, measure, present and disclose long-duration insurance contracts. Key areas discussed by the Board included the reserving model for participating insurance contracts, deferred acquisition costs, the measurement and presentation of market risk benefits, and presentation and disclosure.

The proposed guidance would apply to only those insurance entities within the scope of US GAAP guidance related to insurance contracts (ASC 944). It would exclude holders of insurance contracts and contracts issued by non-insurance entities.

The Board will discuss the effective date at a future meeting.

Resources: KPMG's Defining Issues summarizing the October and November meetings; Proposed ASU

FASB project about disaggregating performance information

The FASB added to its agenda a project about the disaggregation of performance information. The project would consider disaggregation either through presentation in the income statement or through disclosure. The FASB decided to base the project on disaggregating functional lines into natural components.

EITF tentative conclusion on implementation costs for cloud computing arrangements

At its October meeting, the Emerging Issues Task Force (EITF) discussed a customer's accounting for implementation costs incurred in a cloud computing arrangement that is a service contract. The EITF tentatively concluded that cloud computing arrangements and software licensing arrangements are economically similar and should be accounted for consistently. The tentative conclusion would effectively reverse a recent ASU addressing a customer's

accounting for cloud computing arrangements.[5] The EITF directed the FASB staff to perform additional research how to apply the tentative conclusion.

The timing of the next EITF meeting depends on when the FASB staff completes its research and outreach.

Resources: KPMG's Defining Issues, EITF reaches tentative conclusion on implementation of costs for cloud computing

[5] ASU 2015-05, Customer's accounting for fees paid in a cloud computing arrangement.

4 Recommended reading and CPE opportunities

Lease accounting changing

In a byline article for Fort Worth Inc., KPMG's Rayford High advises that new guidelines from the FASB will require companies to account for all leases with a term of 12 months or more on-balance sheet. "For companies with many leases, the amount of work and lead time needed to implement the standard will be significant, even if what is considered a lease doesn't change significantly." Read the article and share with your social networks.

Blockchain to revolutionize the financial industry

In a byline article for CIO Review, Advisory Director, Safwan Zaheer discusses how the 'FinTech Revolution' is transforming the banking industry through innovative use of new technologies and business models. Zaheer advises that although Blockchain technology promises enhanced experiences in dealing with financial services, it is not without challenges. Read the article.

A practical analysis of the new IRS research credit directive

In an article published by Bloomberg BNA, authors from KPMG's Washington National Tax practice say that a new IRS directive intended to reduce the research credit exam burden for large taxpayers and the IRS presents practical and legal application challenges. In addition to providing an overview and explanation of the directive, the article explores various administrative and practical aspects to consider before deciding whether to apply the directive, and includes an impact by industry chart. Read the article and share with your social networks.

Bots, natural language processing, and machine learning

In an article published by Tax Executive Institute, authors from KPMG's Tax and Advisory practices (Steve Rainey, Brad Brown and David Kirk) explore the business effects of rapidly changing technology and its often complicated monikers. The article discusses the evolving field of cognitive computing and provides insights into why intelligent automation can be particularly valuable within the tax function. Read the article and share with your social networks.

Upcoming CPE opportunities

KPMG Executive Education provides a wide range of accounting and finance continuing professional education (CPE) programs in several formats: public seminars, customized on-site instructor-led classes, web-based self-study programs and live webcasts.

KPMG's Financial Reporting View (FRV) offers additional CPE opportunities, including registration information for upcoming CFO Financial Forum webcasts. The webcasts feature KPMG professionals discussing current and forthcoming accounting and financial reporting matters, and guidance for implementing new accounting standards.

5 Appendix – Accounting standards effective dates

Accounting standards affecting public companies in 2017

Calendar year-end public companies are required to begin applying these accounting standards in 2017.

Topic	Effective date for public companies	For more information
Amendments to SEC paragraphs pursuant to staff announcements at the September 22, 2016 and November 17, 2016 EITF meetings	On issuance (January 2017)	ASU 2017-03
Simplifying the measurement of inventory	Annual and interim periods in fiscal years beginning after 12/15/2016	ASU 2015-11 Defining Issues Podcast
Simplifying the presentation of deferred taxes	Annual and interim periods in fiscal years beginning after 12/15/2016	ASU 2015-17 Defining Issues Podcast
Effect of derivative contract novations on existing hedge accounting relationships	Annual and interim periods in fiscal years beginning after 12/15/2016	ASU 2016-05 Defining Issues Podcast
Contingent put and call options in debt instruments	Annual and interim periods in fiscal years beginning after 12/15/2016	ASU 2016-06 Defining Issues Podcast
Simplifying the transition to the equity method of accounting	Annual and interim periods in fiscal years beginning after 12/15/2016	ASU 2016-07 Defining Issues Podcast
Improvements to employee share-based payment accounting	Annual and interim periods in fiscal years beginning after 12/15/2016	ASU 2016-09 Defining Issues Podcast

Topic	Effective date for public companies	For more information
Consideration of interests held through related parties under common control	Annual and interim periods in fiscal years beginning after 12/15/2016	ASU 2016-17 Defining Issues Podcast
Technical corrections (December 2016)	Most amendments were effective on issuance (December 2016). Certain amendments that require transition guidance are effective for annual and interim periods in fiscal years beginning after 12/15/2016.	ASU 2016-19

Accounting standards affecting public companies in 2018 and beyond

Calendar year-end public companies are required to begin applying these accounting standards in 2018 or later and may need to disclose their potential effects in 2017.

Topic	Effective date for public companies	For more information
Revenue recognition	Annual and interim periods in fiscal years beginning after 12/15/2017	ASU 2014-09 ASU 2015-14 ASU 2016-08 ASU 2016-10 ASU 2016-11 ASU 2016-12 ASU 2016-20 ASU 2017-13 ASU 2017-14 KPMG's webpage on Revenue
Recognition and measurement of financial assets and financial liabilities	Annual and interim periods in fiscal years beginning after 12/15/2017	ASU 2016-01 KPMG's webpage on Financial instruments
Recognition of breakage for certain prepaid stored-value products	Annual and interim periods in fiscal years beginning after 12/15/2017	ASU 2016-04 Defining Issues Podcast

Appendix – Accounting standards effective dates

Topic	Effective date for public companies	For more information
Statement of cash flows - classification of certain cash receipts and payments	Annual and interim periods in fiscal years beginning after 12/15/2017	ASU 2016-15 Defining Issues Podcast
Intra-entity transfers of assets other than inventory	Annual and interim periods in fiscal years beginning after 12/15/2017	ASU 2016-16 Defining Issues Podcast
Statement of cash flows - presentation of restricted cash	Annual and interim periods in fiscal years beginning after 12/15/2017	ASU 2016-18 Defining Issues Podcast
Clarifying the definition of a business	Annual and interim periods in fiscal years beginning after 12/15/2017	ASU 2017-01 Defining Issues Webcast
Clarifying the scope of asset derecognition guidance and accounting for partial sales of nonfinancial assets	Annual and interim periods in fiscal years beginning after 12/15/2017	ASU 2017-05 Defining Issues Podcast
Improving the presentation of net periodic pension cost and net periodic postretirement benefit cost	Annual and interim periods in fiscal years beginning after 12/15/2017	ASU 2017-07 Defining Issues Podcast
Scope of modification accounting for share-based payment awards	Annual and interim periods in fiscal years beginning after 12/15/2017	ASU 2017-09 Web article
Identifying the customer in a service concession arrangement	Annual and interim periods in fiscal years beginning after 12/15/2017	ASU 2017-10 Web article Podcast
Leases	Annual and interim periods in fiscal years beginning after 12/15/2018	ASU 2016-02 ASU 2017-13 KPMG's webpage on Leases

Topic	Effective date for public companies	For more information
(Part I) Accounting for certain financial instruments with down round features, (Part II) Replacement of the indefinite deferral for mandatorily redeemable financial instruments of certain nonpublic entities and certain mandatorily redeemable noncontrolling interests with a scope exception	Annual and interim periods in fiscal years beginning after 12/15/2018	ASU 2017-11 Defining Issues
Targeted improvements to accounting for hedging activities	Annual and interim periods in fiscal years beginning after 12/15/2018	ASU 2017-12 Defining Issues
Codification improvements ASC 955, US Steamship Entities	Annual and interim periods in fiscal years beginning after 12/15/2018	ASU 2017-15
Measurement of credit losses on financial instruments	**SEC filers:** Annual and interim periods in fiscal years beginning after 12/15/2019 **Non-SEC filers:** Annual and interim periods in fiscal years beginning after 12/15/2020	ASU 2016-13 Defining Issues KPMG's webpage on Financial instruments
Premium amortization for purchased callable debt securities	Annual and interim periods in fiscal years beginning after 12/15/2018	ASU 2017-08 Defining Issues Podcast
Simplifying the test for goodwill impairment	**SEC filers:** Annual and interim periods in fiscal years beginning after 12/15/2019 **Non-SEC filers:** Annual and interim periods in fiscal years beginning after 12/15/2020	ASU 2017-04 Defining Issues Podcast

Accounting standards affecting private companies in 2017

Calendar year-end private companies are required to begin applying these accounting standards in 2017.

Topic	Effective date for private companies	For more information
Eliminating certain investments from the fair value hierarchy table	Annual and interim periods in fiscal years beginning after 12/15/2016	ASU 2015-07 Defining Issues Podcast
Simplifications for employee benefit plans	Annual and interim periods in fiscal years beginning after 12/15/2016	ASU 2015-12 Defining Issues Podcast
Simplifying the transition to the equity method of accounting	Annual and interim periods in fiscal years beginning after 12/15/2016	ASU 2016-07 Defining Issues Podcast
Consolidation	Annual periods in fiscal years beginning after 12/15/2016, and interim periods in fiscal years beginning after 12/15/2017	ASU 2015-02 Defining Issues Webcast
Practical expedient for the measurement date of an employer's defined benefit obligation and plan assets	Annual periods in fiscal years beginning after 12/15/2016, and interim periods in fiscal years beginning after 12/15/2017	ASU 2015-04 Defining Issues
Disclosures about short-duration insurance contracts	Annual periods in fiscal years beginning after 12/15/2016, and interim periods in fiscal years beginning after 12/15/2017	ASU 2015-09 Issues & Trends In Insurance
Simplifying the measurement of inventory	Annual periods in fiscal years beginning after 12/15/2016, and interim periods in fiscal years beginning after 12/15/2017	ASU 2015-11 Defining Issues Podcast

Topic	Effective date for private companies	For more information
Simplifying measurement-period adjustments	Annual periods in fiscal years beginning after 12/15/2016, and interim periods in fiscal years beginning after 12/15/2017	ASU 2015-16 Defining Issues Podcast
Consideration of interests held through related parties under common control	Annual periods in fiscal years beginning after 12/15/2016, and interim periods in fiscal years beginning after 12/15/2017	ASU 2016-17 Defining Issues Podcast
Clarifying when a not-for-profit entity that is a general partner or a limited partner should consolidate a for-profit limited partnership or similar entity	Annual periods in fiscal years beginning after 12/15/2016, and interim periods in fiscal years beginning after 12/15/2017	ASU 2017-02 Defining Issues Podcast
Technical corrections (December 2016)	Most amendments were effective on issuance (December 2016). Certain amendments that require transition guidance are effective for: — annual and interim periods in fiscal years beginning after 12/15/2016 (for fair value measurements); — annual periods in fiscal years beginning after 12/15/2017, and interim periods in fiscal years beginning after 12/15/2018 (for cloud computing arrangements).	ASU 2016-19

Accounting standards affecting private companies in 2018 and beyond

Calendar year-end private companies are required to begin applying these accounting standards in 2018 or later.

Topic	Effective date for private companies	For more information
Scope of modification accounting for share-based payment awards	Annual and interim periods in fiscal years beginning after 12/15/2017	ASU 2017-09 Web article
Simplifying the presentation of deferred taxes	Annual periods in fiscal years beginning after 12/15/2017, and interim periods in fiscal years beginning after 12/15/2018	ASU 2015-17 Defining Issues Podcast
Effect of derivative contract novations on existing hedge accounting relationships	Annual periods in fiscal years beginning after 12/15/2017, and interim periods in fiscal years beginning after 12/15/2018	ASU 2016-05 Defining Issues Podcast
Contingent put and call options in debt instruments	Annual periods in fiscal years beginning after 12/15/2017, and interim periods in fiscal years beginning after 12/15/2018	ASU 2016-06 Defining Issues Podcast
Improvements to employee share-based payment accounting	Annual periods in fiscal years beginning after 12/15/2017, and interim periods in fiscal years beginning after 12/15/2018	ASU 2016-09 Defining Issues Podcast
Presentation of financial statements of not-for-profit entities	Annual periods in fiscal years beginning after 12/15/2017, and interim periods in fiscal years beginning after 12/15/2018	ASU 2016-14
Codification improvements to ASC 955, US Steamship Entities	Annual and interim periods in fiscal years beginning after 12/15/2018	ASU 2017-15

Appendix – Accounting standards effective dates

Topic	Effective date for private companies	For more information
Revenue recognition	Annual periods in fiscal years beginning after 12/15/2018, and interim periods in fiscal years beginning after 12/15/2019	ASU 2014-09 ASU 2015-14 ASU 2016-08 ASU 2016-10 ASU 2016-12 ASU 2016-20 KPMG's webpage on Revenue
Recognition and measurement of financial assets and financial liabilities	Annual periods in fiscal years beginning after 12/15/2018, and interim periods in fiscal years beginning after 12/15/2019	ASU 2016-01 KPMG's webpage on Financial instruments
Recognition of breakage for certain prepaid stored-value products	Annual periods in fiscal years beginning after 12/15/2018, and interim periods in fiscal years beginning after 12/15/2019	ASU 2016-04 Defining Issues Podcast
Statement of cash flows - classification of certain cash receipts and payments	Annual periods in fiscal years beginning after 12/15/2018, and interim periods in fiscal years beginning after 12/15/2019	ASU 2016-15 Defining Issues Podcast
Intra-entity transfers of assets other than inventory	Annual periods in fiscal years beginning after 12/15/2018, and interim periods in fiscal years beginning after 12/15/2019	ASU 2016-16 Defining Issues Podcast
Statement of cash flows - presentation of restricted cash	Annual periods in fiscal years beginning after 12/15/2018, and interim periods in fiscal years beginning after 12/15/2019	ASU 2016-18 Defining Issues Podcast

Appendix – Accounting standards effective dates

Topic	Effective date for private companies	For more information
Clarifying the definition of a business	Annual periods in fiscal years beginning after 12/15/2018, and interim periods in fiscal years beginning after 12/15/2019	ASU 2017-01 Defining Issues Webcast
Clarifying the scope of asset derecognition guidance and accounting for partial sales of nonfinancial assets	Annual periods in fiscal years beginning after 12/15/2018, and interim periods in fiscal years beginning after 12/15/2019	ASU 2017-05 Defining Issues Podcast
Employee benefit plan master trust reporting	Annual periods in fiscal years beginning after 12/15/2018	ASU 2017-06
Improving the presentation of net periodic pension cost and net periodic postretirement benefit cost	Annual periods in fiscal years beginning after 12/15/2018, and interim periods in fiscal years beginning after 12/15/2019	ASU 2017-07 Defining Issues Podcast
Identifying the customer in a service concession arrangement	Annual periods in fiscal years beginning after 12/15/2018, and interim periods in fiscal years beginning after 12/15/2019	ASU 2017-10 Web article Podcast
Leases	Annual periods in fiscal years beginning after 12/15/2019, and interim periods in fiscal years beginning after 12/15/2020	ASU 2016-02 KPMG's webpage on Leases
Premium amortization for purchased callable debt securities	Annual periods in fiscal years beginning after 12/15/2019, and interim periods in fiscal years beginning after 12/15/2020	ASU 2017-08 Defining Issues Podcast

Topic	Effective date for private companies	For more information
(Part I) Accounting for certain financial instruments with down round features, (Part II) Replacement of the indefinite deferral for mandatorily redeemable financial instruments of certain nonpublic entities and certain mandatorily redeemable noncontrolling interests with a scope exception	Annual periods in fiscal years beginning after 12/15/2019, and interim periods in fiscal years beginning after 12/15/2020	ASU 2017-11 Defining Issues
Targeted improvements to accounting for hedging activities	Annual periods in fiscal years beginning after 12/15/2019, and interim periods in fiscal years beginning after 12/15/2020	ASU 2017-12 Defining Issues
Measurement of credit losses on financial instruments	Annual periods in fiscal years beginning after 12/15/2020, and interim periods in fiscal years beginning after 12/15/2021	ASU 2016-13 Defining Issues KPMG's webpage on Financial instruments
Simplifying the test for goodwill impairment	Annual and interim periods in fiscal years beginning after 12/15/2021	ASU 2017-04 Defining Issues Podcast

KPMG Financial Reporting View

Insights for financial reporting professionals

As you evaluate the implications of new financial reporting standards on your company, KPMG Financial Reporting View is ready to inform your decision-making.

Visit kpmg.com/us/frv for accounting and financial reporting news and analysis of significant decisions, proposals, and final standards and regulations.

FRV focuses on major new standards (including revenue recognition, leases and financial instruments) – and also covers existing US GAAP, IFRS, SEC matters, broad transactions and more.

kpmg.com/us/frv
Insights for financial reporting professionals

Acknowledgments

This is a publication of the Department of Professional Practice of KPMG LLP in the United States.

Angie Storm
Partner

Robin Van Voorhies
Director

kpmg.com/socialmedia