Jnet newsletter

U.S. business update for Japanese companies

Issue 3 - 2018

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KPMG's U.S. Japanese Practice

Contents

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U.S. business update for Japanese companies

Board's-eye View of Data and Analytics

Automation. Robotics. Cognitive computing. Artificial intelligence.

An explosion of data and major strides in analytics are challenging companies to reassess their policies, infrastructure, and capabilities around the use of technology, data and analytics (D&A), privacy, cybersecurity, and financial reporting in order to make better business decisions.

Given their oversight roles, how can boards and audit committees help ensure that the company is getting the appropriate insights while taking the necessary precautions to protect the company, its employees, customers, and others?

"The first thing boards need to ask is 'how is the company itself organizing its data and who is responsible for it?'" said Roger O'Donnell, Global Head of Audit Data and Analytics for KPMG. "And, more broadly, the board needs to think about the company's strategy and ensure that its policies for collecting and using data make sense in the context of the business. If something were to happen that was not intended, does the board understand the potential risk to the business and the brand?"

O'Donnell was joined in the discussion of D&A oversight on the March KPMG/NACD Quarterly Audit Committee Webcast by moderator Jose R. Rodriguez, Executive Director and Partner-in-Charge of the KPMG Audit Committee Institute.

According to the 2017 KPMG CEO survey, 71 percent of CEOs consider their company to be a "technology company," yet 49 percent have concerns about the integrity of the data on which they base decisions; and 61 percent are concerned about integrating artificial intelligence and machine learning into their business operations. These challenges —and the accelerating pace and complexity of data-driven technologies —highlight the critical role boards and audit committees have to play in helping to assess the risks and opportunities presented by the company's use of data and analytics.

Data strategy

Boards and audit committees should have a holistic view of the company's strategy around D&A— specifically what data is collected, how it is used, and who oversees that effort. Some companies employ a chief data officer, others have an aggregate data function with the office of the chief information officer, and, in many cases, the CFO's office is becoming much more involved, said O'Donnell.

Among the key questions for directors to consider:

- How is the data being collected and organized within the company and who is involved? Ultimately, who is responsible?
- Can the data be trusted? How is the quality and integrity of the data assessed?
- Does the company have a data ethics policy to protect the brand reputation and reduce legal risk?
- Does the company have the right talent, skills, and resources required to implement/manage its D&A activities?
- Has the company scoped out the near-term and longer-term opportunities for its use of D&A, including financial reporting and predictive analytics?

Data security and protection

O'Donnell says that this conversation for directors is two-fold: "There are security decisions related to your infrastructure choice—on-site hardware versus cloud, but there are also questions for boards to consider around what type of information and data is captured and how it is used." With regard to the strategy that the company has set forth, does the way the company is utilizing information, specifically customer data, align with customer understanding and privacy expectations? "This has to go right through the CEO's office to ensure that there's a strategy in place so that everyone understands what data is being collected, how it is being utilized, and who is receiving it," said O'Donnell.

"I think boards have a responsibility to ensure that they're protecting the business and the brand and to ensure that customers aren't going to feel that their privacy was violated or manipulated or their information was used in a manner for which it wasn't originally provided," said O'Donnell.

Internal audit's focus and resources

Digital advances in areas such as mobile and cloud computing, automation, and artificial intelligence are transforming the ways companies do business, creating demand for new and improved internal controls and risk management. At the same time, automation and advanced analytics are helping internal audit improve performance. Adoption of digital technologies also creates challenges for internal audit that audit committees may want to focus on. "What's the resource complement for internal audit, as well as others in the organization, to help support greater analysis of things like procurement decisions and T&E?" asks O'Donnell.

O'Donnell suggests looking at what the company can automate into an analysis platform—general ledger information, journal entries, customer data—and presenting that to internal audit to better focus their analysis.

External audit and financial reporting

Regarding the external audit and the development of smart audit platforms, O'Donnell says that greater use of data and analytics in the audit can enable more analysis of larger volumes of data, which can help the audit team to better assess anomalies, exceptions, and how to handle them. Other outcomes include earlier indicators of control risk, greater scenario analysis, stress testing, and customer trends as indicated in the figure on the next page.

"From an audit perspective, we can move from limited samples to a place of complete analysis and looking at 100 percent of transactions," said O'Donnell. "I use the word 'analysis' as opposed to 'audit' because I think the combination of D&A and auditor determinations is going to give the company indications and information that management can react to." These technologies don't eliminate the need for people. There can still be false positives and false negatives because the number of anomalies in a larger data pool will, by definition, be bigger."

"Putting together structured and unstructured data, having the expertise to unpack the information, and then having the right skill sets to look at how information comes together to drive analytics and business decisions all depend on whether the right questions are being asked," said O'Donnell. With greater insight, the company's view on revenue, valuation, and even credit decisions can become more predictive. How might the company gain insight and better communicate information on adjusted non-GAAP earnings and non- financial metrics, the value of intangible assets, and key performance indicators? How can the company use D&A to fine-tune projections?

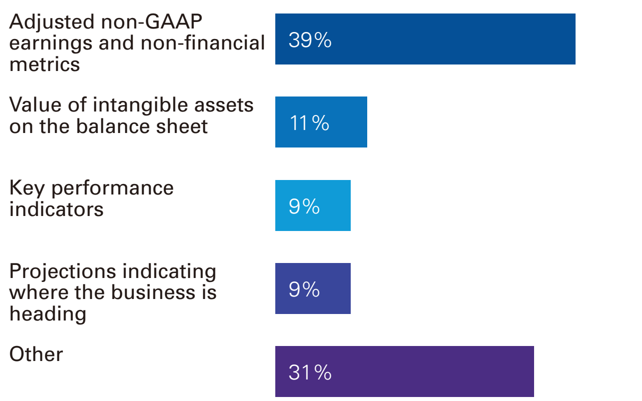
A holistic view

As board members think through the challenges that exist with the advancement of D&A, it's also important to view the opportunities and the long-term benefits, said O'Donnell. "Does the company have the right workforce with the right skillsets to manage through these changes? Has the board ensured the right level of governance and oversight to serve the company as it implements new systems and processes and also to help protect the data that the company captures and the information it derives?"

Real-life decisions

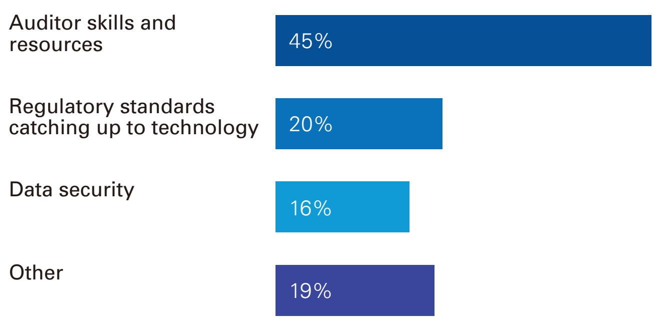
From shirts with biometric capabilities to engines that are capturing data, companies are gathering more information to help them make better decisions, for everything from vehicle maintenance schedules to personal health and well-being. Banks can monitor customer spending patterns and user locations to decide whether to deny credit card transactions to help prevent fraud. IBM Watson is helping medical providers analyze cancer treatment cure rates based on patient data in order to suggest more effective, personalized courses of treatment. This type of information flow and related action can add value in the supply chain, to investment decisions, and even in financial reporting.

Looking forward, in which areas would the auditor's use of technology/data and analytics provide the greatest value and insights to investors:



Of 658 audit committee members, other directors and C-level executives surveyed during the Webcast on March 22, 2018. Percentages may not equal 100 due to rounding.

In your view, what are the greatest challenges to integrating data and analytics into the audit?



Of 658 audit committee members, other directors and C-level executives surveyed during the Webcast on March 22, 2018.

For the full replay and other highlights, visit kpmg.com/aciwebcast.

Opportunity presented by data and technology

Digital automation

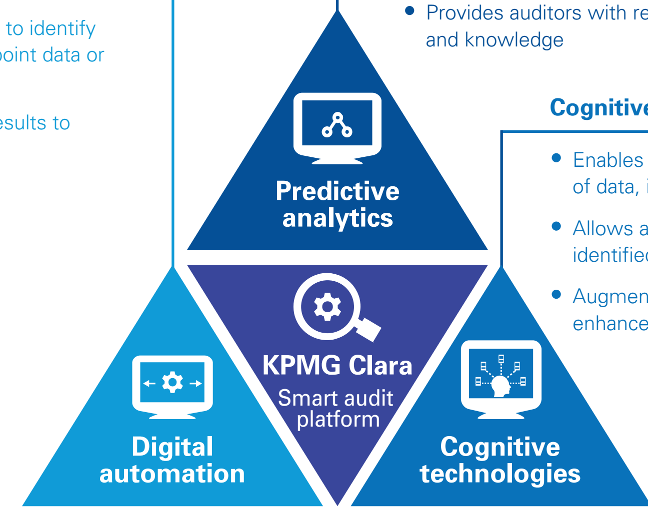
- Allows for evaluation of larger data sets
- Enables a more granular analysis of underlying data and use of algorithms/rules
- Supports the auditor's ability to identify unique transactions and pinpoint data or performance anomalies
- Enhances visualizations of results to facilitate interpretation

Predictive analytics

- Enables a deeper and more robust understanding of business risks by using client's data combined with an analysis of industry or market data
- Provides auditors with refined analytical capabilities and knowledge

Cognitive technologies

- Enables the analysis of larger volumes of data, in particular unstructured data
- Allows auditors to dig deeper into identified exceptions
- Augments professional judgment and enhances decision making



Key questions for boards to ask regarding D&A:

- Are current and future business challenges being effectively aligned with the right data and technology solutions?
- Has management assessed the data infrastructure and the data available to drive the digital strategy? Who is accountable for data decisions and the associated risks?
- Has management assessed the ability of the IT infrastructure to support these advanced technologies?
- What is the current workforce's skill set? Where does it need to be?
- Has an appropriate governance structure been put in place, including the board and its committees, to manage such innovation and change?

Critical issues for audit committees:

- Understand how finance, internal audit, operations, controllership, the external auditor, and others within the organization expect to use advanced data and analytics in the next several years. It has to be a coordinated effort.
- Understand how management will oversee and govern this transformation in relation to costs, quality, talent, controls, key performance indicators, etc. What resources, technologies, and skills will be required? What controls are in place? What is internal audit's role?
- How will data be secured and protected? Is the company managing/using the data in a way that aligns with customer expectations? Are the policies and processes around that clearly articulated and understood, both internally and externally?

About the KPMG Board Leadership Center

The KPMG Board Leadership Center champions outstanding governance to help drive long-term corporate value and enhance investor confidence. Through an array of programs and perspectives—including KPMG's Audit Committee Institute, the WomenCorporateDirectors Foundation, and more—the Center engages with directors and business leaders to help articulate their challenges and promote continuous improvement of public- and private-company governance. Drawing on insights from KPMG professionals and governance experts worldwide, the Center delivers practical thought leadership—on risk and strategy, talent and technology, globalization and compliance, financial reporting and audit quality, and more—all through a board lens. Learn more at kpmg.com/blc.

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Audit Committee Institute

Part of the Board Leadership Center, KPMG's Audit Committee Institute focuses on oversight of financial reporting and audit quality and other issues of interest to audit committee members, including risk oversight, internal controls, and compliance. Learn more at kpmg.com/aci.

Questions?

If you have any questions about this article please reach out to your KPMG engagement team or the contact listed with this article.

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From Transaction Processing to Driving Business Results: GBS as a Strategic Partner

Global business services as a strategic partner in industrial manufacturing

From transaction processing to driving business results

Numerous objectives—cost reduction, process improvement, enhanced insights, modernization, to name a few—are accelerating the need for a mature global business services (GBS) organization within industrial manufacturing (IM) companies, prompting many to investigate new ways to transform this traditionally back-office organization into a strategic business partner.

Industrial manufacturing companies are elevating the role of global business services, adding more value across the enterprise

There was a time, not long ago, when the foundational "keep the lights on" work done every day by GBS was focused on delivering back-office processes at the lowest cost, rather than its contributions to the company's strategic objectives.

Today, organizations large and small are witnessing sweeping technology-driven changes—geopolitical, economic and cultural—that will impact their operating models, the way they interact with customers, and the products and services they offer. These external forces—from the rise of intelligent automation to immigration and tax reform—are among the disruptors prompting many IM companies to reconsider the role of GBS within the context of corporate competitiveness.

Properly managed and aligned with business strategy, a mature GBS organization can become the strategic partner IM companies need to drive value in a rapidly changing environment. Data analysis and interviews with market leaders and shapers confirm a growing appetite to improve the maturity of the GBS organization and elevate its role.

In contrast to the traditional role of primarily delivering back-office services, the new vision for GBS is one of a strategic, collaborative contributor to the business, long-term value and sustainability. More and more, GBS organizations are expected to deliver differentiated, value-added services. The thinking is not only will this drive the company's overarching strategic objectives but also propel numerous vital business objectives including business intelligence, talent retention and conversion, and even new-market entry.

This paper explores the growing movement to give GBS leaders a seat at the C-suite executive table. We are confident that this change will help IM companies drive new business opportunities; improve customer experience; reduce selling, general, and administrative (SG&A) expenses; and better manage risk. We also outline KPMG's approach to progressing IM companies' GBS maturity, on which the entire endeavor hinges.

For more information, download the full report below.

Download Now

From Transaction Processing to Driving Business Results: GBS as a Strategic Partner > (PDF/1MB)

https://advisory.kpmg.us/content/dam/advisory/en/pdfs/gbs-as-strategic-partner.pdf

Questions?
If you have any questions about this article please reach out to your KPMG engagement team or email us at us-kpmg-jp@kpmg.com.

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Blockchain and the Future of Finance

A potential new world for CFOs—and how to prepare

Imagine a world with no out-of-sync ledgers. No need for reconciliations. No fragmented or hidden data that create multiple versions of the truth.

In this world, you would have just one version of a ledger, with simultaneous settlements that are seen by all parties. You could get instant visibility on the status of accounts receivable, supply chain movements, and other transactions. You would have a transparent, chronological history of events for a single source of truth.

This world is coming, and its name is blockchain. As a revolutionary technology for recordkeeping, it is poised to change the future of finance—in accounting, asset registers, payments, trading, collateral management, and more.

How should you prepare for this wave of disruption? What are the implications for your finance organization? Inside, we explore the principles of blockchain through a finance lens, including a framework for projecting the impact on core processes and our hypotheses for a blockchain world.

What is a blockchain?

Traditional financial systems operate with a centralized database, usually with a single point of authority. Blockchain technology, on the other hand, allows for a distributed database that holds a growing number of records. Instead of existing in one place, the ledger is continually updated and synchronized across multiple computers in a network. Therefore, any participant in the network with the proper authorization can view the entire ledger—without relying on an intermediary or any one authority.

As each transaction occurs, it is stored chronologically in a block, and each block is connected to the one before and after it. To ensure data integrity and security, all parties in the network must validate each transaction—using agreed mathematical formulas called consensus mechanisms— and each block is secured by cryptography.

As such, the blocks form a permanent, chronological chain of transactions that cannot be changed without the approval of other participants. It is as if a notary is present at every transaction, and the blockchain leaves a public audit trail of all activities, accessible to those with the proper permissions. As a result, all authorized parties in the network have access to a single, shared source of truth, which may foster trust across multiple sites or geographies.

Another key feature of blockchain technology is a "smart contract," which is a self-executing protocol that enforces a previously agreed arrangement. For example, a smart contract could trigger an automatic refund under certain conditions or the automatic payment of an agreed commission after a sale. These smart contracts can eliminate delays in traditional finance processes, while increasing transparency and reducing reliance on middlemen to follow through on their commitments. Moreover, like other parts of a blockchain, smart contracts are immutable, so they can enhance accuracy in the financial statements.

Getting ready for a blockchain world

VC investment in blockchain achieved a record high of **$512 million** in 2017, up from $15 million in 2013. [1]

By 2021, **at least 25% of the Global 2000** will use blockchain as a foundation for digital trust at scale. [2]

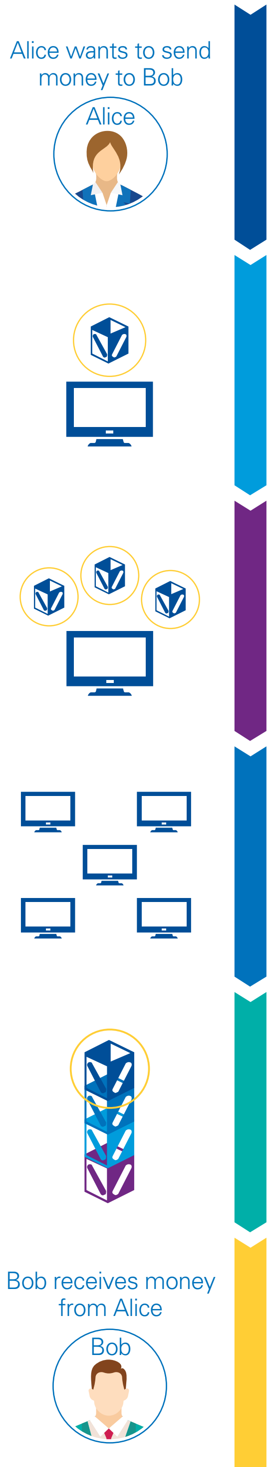
The business value added by blockchain will surpass **$176 billion** by 2025 and **$3.1 trillion** by 2030. [3]

[1] KPMG International (data provided by PitchBook), *The Pulse of Fintech Q4 2017: Global Analysis of Investment in Fintech* (February 2018).

[2] International Data Corporation (IDC), *FutureScape: Worldwide IT Industry 2018 Predictions* (February 2018).

[3] Gartner, Inc., *Practical Blockchain: A Gartner Trend Insight Report* (March 2017).

How it works: blockchain basics



Transaction is initiated.

Transactional data is recorded as a block.

The block is broadcast to all authorized parties on the network, which are linked by software.

Those in the network validate the transaction through consensus mechanisms, which can help create trust among parties.

The block is added to the chain as a permanent record, providing an audit trail to those with the proper permissions.

Transaction is completed. The block gives way to the next block in the chronological chain. All authorized parties in the network have access to a shared, single source of truth.

Implications for finance

These principles of blockchain technology hold great promise for finance organizations, including quantitative and qualitative benefits. Among them:

- **Increased efficiency from transparent records and a single source of truth.** By creating one version of a ledger that is synchronized across computers, blockchain can help eliminate out-of-sync ledgers and, therefore, the need for reconciliations. Transparency may also lead to other benefits. In trade finance, for example, all parties will be able to see when goods have shipped and review all steps of the transaction, which may significantly reduce the settlement time.
- **Enhanced data integrity to reduce loss.** With immutable records that are visible to everyone involved, blockchain may improve data accuracy and security, help reduce the risk of fraud, and show compliance through an audit trail. For example, when supply chain information is put on a blockchain, companies can potentially reduce fraud and errors, improve inventory management, identify issues more quickly, reduce delays from paperwork, and increase trust among all parties. Blockchain also offers the potential to create a single source of information around customer identity, reducing costs and risk related to Know-Your- Customer regulations.
- **Improved customer experience through faster processing.** By using blockchain to share information with clients and vendors, companies may be able to tap sales opportunities and serve customers far more quickly than with traditional systems for setting up new relationships. Blockchain can also enable consolidated, accurate repositories of customer information that can be accessed by all parties in the network.
- **Higher availability of capital and lower cost of business.** Thanks to consensus mechanisms and smart contracts, blockchain can minimize the time that capital is tied up for a transaction, instead triggering an automatic transfer of funds upon an agreed set of conditions. Blockchain will also eliminate some transaction fees by reducing reliance on third parties, and it will likely free up capital flows as the purchase of managed funds moves to real time.

Potential benefits of blockchain*

Up to 95% reduction in errors,
due to the elimination of out-of-sync ledgers and reconciliations

Up to 40% increase in efficiency,
due to straight-through processing and a single source of truth

Up to 25% improvement in customer experience,
due to faster processing and use of digital channels

Up to 75% reduction in capital consumption,
due to quicker settlement of trades, straight- through processing, and freed-up capital flows

* Based on KPMG LLP (KPMG) research

The impact on core processes

How will these kinds of benefits manifest in core finance processes? To project the impact and determine which processes are best suited for blockchain, KPMG developed a framework that evaluates each core process on four key factors:

1. **Is it rule-based?** The more standardized a process is, the better suited it is for smart contracts in a blockchain.
2. **Is the data fragmented, with multiple versions of the truth?** Blockchain brings a clear benefit to fragmented data: a single source of truth that is synchronized across stakeholders.
3. **Does a process require manual intervention?** The greater the need for reconciliations, the greater the opportunity for blockchain to obviate them—by enabling all parties to view all transactions at their source.
4. **How many stakeholders are involved?** When a process involves many parties, blockchain can bring value through distributed ledgers and transparent records that give all stakeholders access to the same data at the same time.

These four criteria can be applied to all core processes, helping finance organizations contemplate the impact of blockchain on their service delivery.

Blockchain's projected impact on core finance processes

Process:	*Projected impact:*
Acquire-to-retire	HIGH
Source-to-pay	
Quote-to-cash	
Record-to- report	MODERATE
Payroll	
Plan-to-perform	LOW

For example, consider the quote-to-cash process. With activities like credit history analysis, product/service management, and accounts receivable, the process is highly standardized and rule-based—without a lot of judgment or individual discretion. And while most companies are working to centralize their data, many still have it housed in several enterprise resource planning (ERP) systems.

Accordingly, manual effort is often required to update data from one system to the next or correct associated errors, such as inaccurate information on invoices, which can slow down the receivables process. Finally, quote-to-cash clearly involves numerous stakeholders—from customer qualification through to collections—and there is often a lack of transparency between entities.

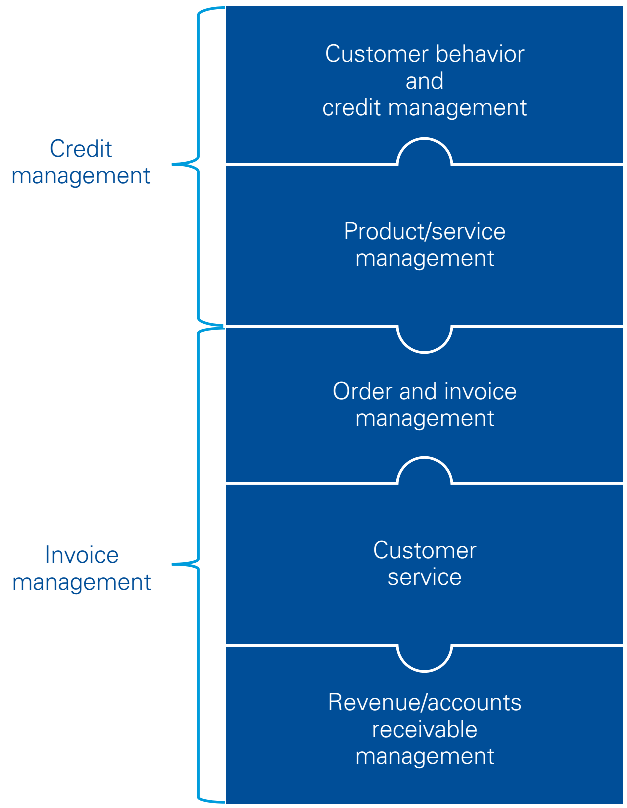
Based on these process characteristics, blockchain technology may bring significant improvements throughout quote-to-cash:

- **Customer behavior and credit management.** A blockchain can serve as a master file of customer data—including contact information, transactions, third-party credit ratings, and more—for real-time clarity and accuracy on each customer.
- **Product/service management.** Blockchain can enable a continually updated master file of products and services, allowing participants throughout the supply chain to work from the same source of truth. For example, as retailers offer more options for personalized products, blockchain is being leveraged in order to provide reliable, accurate visibility to an increasingly complex inventory. This visibility may also improve SKU forecasting, helping companies reduce lost sales due to out-of-stock products, while minimizing write-offs due to over-ordering.
- **Order and invoice management.** A blockchain for omnichannel order management could provide each participant in the supply chain with an always-up-to- date ledger of inventory, orders, and fulfillment status. Such a distributed ledger would allow for automated payments and reporting.
- **Customer service.** Smart contracts can help address exceptions and reduce the number of disputes. For instance, if a customer orders five products and receives only three, transparency in the blockchain would make the situation known to all parties, and a smart contract could trigger automatic payment in the right amount.
- **Revenue/accounts receivable management.** Finally, the transparency of a blockchain will provide companies with real-time visibility on the precise status of open invoices, which will reduce manual effort and lags in payment processing.

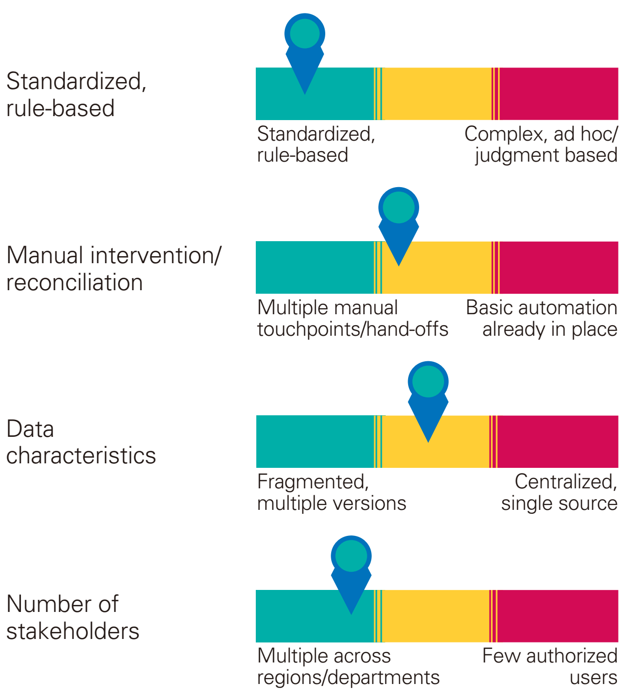
While quote-to-cash is a great candidate for blockchain, with a potential for high impact, other core processes are less well suited, as everything in finance is not necessarily made better by blockchain. Some processes will be better served by conventional databases and a digital overhaul.

Impact analysis: Quote-to-cash

Process decomposition



Evaluation of the four factors



Projected impact: HIGH

Part of a new future for finance

Blockchain clearly will have significant impacts on the finance function, and most organizations will gradually adopt the technology as they envision a new operating model for finance. We anticipate the following key trends:

- **Blockchains will connect to existing financial systems.** Despite the benefits of blockchain, it will not replace traditional ERP systems overnight. Rather, distributed ledgers initially will supplement the systems of record, specifically in cases where balances are frequently recalculated as transactions occur. And while blockchain enables a real-time view of data, the integration with legacy systems may cause a delay in harnessing the ultimate value of the distributed ledgers.
- **Blockchains will be a hybrid of private and public ledgers.** As blockchain technology evolves, we expect finance organizations to start with private blockchains— such as a ledger shared within a company or shared by a company and a vendor—which will enable them to retain sensitive data while gradually embracing more public ledgers. These could include permissioned blockchains for industry consortia and other entities, as well as truly public blockchains that operate in an open marketplace.
- **The regulatory environment will remain in flux.** As blockchain decentralizes financial activities, governments will continue striving to understand and regulate the technology. And those that do so effectively will have an opportunity to attract global investment and become frontrunners in a blockchain economy.

From a new level of data transparency to extreme efficiency gains, blockchain opens finance organizations to a world of new possibilities. But it also opens them to new questions, such as:

- What kinds of business transactions and pain points are best suited for blockchain, and which are better addressed by other technologies?
- What kind of infrastructure will be required, and how will it be funded?
- Who will be in charge of managing a blockchain and admitting new participants? How will this impact talent management strategies?
- How can blockchain impact the finance function’s role as an enterprise data steward, as well as the CFO’s approach to innovation and investment?
- How can blockchain improve risk management?

The answers to these kinds of questions will pave the way to the blockchain world, helping CFOs embrace a new future for finance.

Taking action

A global custodian bank wanted to understand how its transaction banking unit could leapfrog competitors by providing a real-time, transparent, and seamless global payment experience to clients without making a large investment in a new global payment system.

The custodian engaged KPMG to help develop a case for change to efficiently and effectively achieve this goal. Working with both the client and a payment protocol and exchange network developer, KPMG developed a distributed ledger overview document highlighting benefits, capabilities, and use cases to share with key stakeholders.

This featured a conceptual design of a distributed ledger cross-border, cross-currency payment system focused on optimizing clients’ global remittance capabilities. Opportunities to increase efficiency and rationalization in the custodian’s global operations unit were also identified.

Once equipped with the conceptual design and pertinent information, the custodian was able to further its blockchain and global payment strategy.

How KPMG can help

KPMG's Financial Management practice along with our Digital Ledger Services team can help your organization seize the potential of blockchain. Our suite of services provides full support at every stage of development—from proof of concept to designing relevant use cases, integrating systems and operations, through to ongoing management support.

Embracing a rapidly-advancing new technology that disrupts business as usual is not always easy. KPMG will help keep you educated on the growing blockchain ecosystem, informed of new blockchain developments, and aware of the evolving regulatory landscape. Our tailored approach incorporates strategy, security, cost, privacy, performance, risk management, and more.

About KPMG

KPMG LLP, the audit, tax, and advisory firm, is the U.S. member firm of KPMG International Cooperative ("KPMG International"). KPMG is a global network of professional services firms providing audit, tax, and advisory services. We operate in 154 countries and territories and have 200,000 people working in member firms around the world.

To learn more about KPMG's digital ledger services, visit: kpmg.com/us/DigitalLedgerServices.

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

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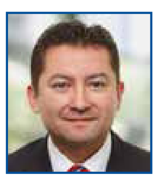

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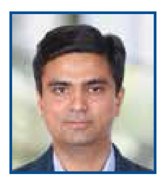

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Questions?

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U.S. business update for Japanese companies

Auditing & Accounting Update

In this section, we provide brief updates on regulatory developments in auditing and accounting that may impact Japanese companies in the United States. Further discussion of the issues can be found in KPMG's Department of Professional Practice's Defining Issues
http://search.kpmginstitutes.com/?bigi=1&q=Defining+Issues&x=0&y=0

SEC proposes amendments to auditor independence rules

Defining Issues 18-5 reports on the SEC's proposed changes to auditor independence rules related to certain loans or debtor-creditor relationships. The SEC's proposal includes four amendments to the loan provision that it believes would effectively identify relationships that could impair an auditor's objectivity and impartiality.

Go to Defining Issues 18-5 (PDF) >
https://frv.kpmg.us/content/dam/kpmg-frv/pdf/2018/defining-issues-18-5-sec-auditor-independence.pdf

EITF reaches a final consensus on implementation costs for cloud computing and a consensus-for-exposure

Defining Issues 18-6 reports on the EITF actions related to three issues, including a final consensus on customers' accounting for implementation costs in cloud computing arrangements. The EITF also reached a consensus-for-exposure on the recognition of revenue performance obligations in a business combination, and discussed the accounting for development costs of episodic television series.

Go to Defining Issues 18-6 (PDF) >
https://frv.kpmg.us/content/dam/kpmg-frv/pdf/2018/defining-issues-18-6-eitf-reaches-consensus-on-implementation-costs-for-cloud-computing.pdf

FASB Transition Resource Group discusses potential changes to the credit losses standard

Defining Issues 18-7 reports on the TRG discussion about estimating credit losses, including accrued interest and the timing of recognition of recoveries. The TRG discussed five issues that were raised. The FASB Staff summarized responses to technical inquires and indicated additional issues that will be discussed by the Board in a future meeting.

Go to Defining Issues 18-7 (PDF) >
https://frv.kpmg.us/content/dam/kpmg-frv/pdf/2018/defining-issues-18-7-credit-losses-trg.pdf

FASB simplifies the accounting for share-based payments to nonemployees

Defining Issues 18-8 reports on ASU 2018-07, which more closely aligns the accounting for employee and nonemployee share-based payments. However, differences remain in the accounting for attribution and a contractual term election for valuing nonemployee equity share options.

Go to Defining Issues 18-8 (PDF) >
https://frv.kpmg.us/content/dam/kpmg-frv/pdf/2018/di-fasb-simplifies-the-accounting-for-share-based-payments-to-nonemployees.pdf

FASB clarifies how not-for-profits and others account for grants and similar transactions

Defining Issues 18-9 reports on the FASB's ASU that clarifies how not-for-profits and others account for grants and similar transactions. The ASU addresses practice issues by helping an entity evaluate whether it should account for a grant or similar contract as a contribution or as an exchange transaction.

Go to Defining Issues 18-9 (PDF) >
https://frv.kpmg.us/content/dam/kpmg-frv/pdf/2018/defining-issues-fasb-clarifies-how-nfps-and-others-account-for-grants.pdf

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

Defining Issues 18-10 reports on the SEC staff's observations about the progress on accounting for tax reform and implementation of the revenue, leases and credit losses standards. SEC Deputy Chief Accountant Sagar Teotia reminded registrants to consider the staff observations and thoughtfully evaluate their own progress on implementation.

Go to Defining Issues 18-10 (PDF) >
https://frv.kpmg.us/content/dam/kpmg-frv/pdf/2018/defining-issues-18-10-sec-staff-accounting-standards.pdf

Financial reporting considerations for companies with operations in Argentina

Defining Issues 18-11 reports on Argentina's classification as having a highly inflationary economy and explains what actions companies need to take. KPMG expects calendar year-end companies to conclude that Argentina's economy is highly inflationary no later than June 30, 2018.

Go to Defining Issues 18-11 (PDF) >
https://frv.kpmg.us/content/dam/kpmg-frv/pdf/2018/defining-issues-18-11-argentina-inflation.pdf

Supreme Court overturns 'physical presence' standard in Wayfair decision

Defining Issues 18-12 reports on the effect on the financial reporting effects of states potentially requiring companies to collect sales and use taxes, even if they lack physical presence in the state. We believe companies will need to consider whether the Supreme Court's decision means that they will need to recognize financial statement liabilities and provide additional disclosures.

Go to Defining Issues 18-12 (PDF) >
https://frv.kpmg.us/content/dam/kpmg-frv/pdf/2018/defining-issues-18-12-supreme-court-overturns-physical-presence-standard.pdf

Blockchain and digital currencies challenge traditional accounting and reporting models

Defining Issues 18-13 reports on blockchain technologies, including digital assets such as cryptocurrencies, and discusses their effect on internal controls and business processes. The accounting for digital assets is an emerging area, and so far neither the FASB nor the IASB have provided specific accounting guidance.

Go to Defining Issues 18-13 (PDF) >
https://frv.kpmg.us/content/dam/kpmg-frv/pdf/2018/defining-issues-18-13-blockchain.pdf

SEC updates smaller reporting company definition

Defining Issues 18-14 reports on the SEC's amended definition of 'smaller reporting company'. The new definition allows more registrants to take advantage of scaled disclosures.

Go to Defining Issues 18-14 (PDF) >
https://frv.kpmg.us/content/dam/kpmg-frv/pdf/2018/defining-issues-18-14-sec-smaller-reporting-companies.pdf

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Questions?
If you have any questions about this article please reach out to your KPMG engagement team or the contact listed with this article.

KPMG

Jnet newsletter

U.S. business update for Japanese companies

Tax Update

In this section of Jnet, we provide brief updates on legislative, judicial, and administrative developments in tax that may impact Japanese companies operating in the United States.

July 2018

Bill to Repeal Medical Device Excise Tax

July 25, 2018

The U.S. House of Representatives on July 24, 2018, passed H.R. 184—a bill that would permanently repeal the tax on medical devices, by a vote of 283-132, with 57 Democrats voting in support of the legislation. Read H.R. 184 [PDF 114 KB]

Bill to Repeal Medical Device Excise Tax

July 24, 2018

Chairman Kevin Brady (R-TX) of the U.S. House Ways and Means Committee today released a two-page document on "tax reform 2.0."

The release [PDF 617 KB] titled, House GOP Listening Session Framework: Tax Reform 2.0, briefly outlines plans to make permanent the individual and small business tax cuts from the new tax law (enacted in December 2017); to promote family savings; and to spur new business innovation.

According to the release, "tax reform 2.0" would:

- Help new businesses write off more of their initial start-up costs
- Make the individual and small business tax cuts permanent
- Help businesses provide retirement plans for workers and help workers participate in retirement plans
- Encourage savings through "USA accounts" (a flexible savings tool for families), expanded section 529 education accounts, and "new baby" savings accounts

These proposals are not described in detail, but are part of a very high-level outline.

IRS Provides Draft Schedule A, "Itemized Deductions" for 2018

July 11, 2018

The IRS released a draft version of Schedule A, "Itemized Deductions" to be filed by those individual taxpayers who will elect to itemize deductions for tax year 2018 when they file Form 1040, "U.S. Individual Income Tax Return."

The draft Schedule A [PDF 102 KB] has a watermark date of "July 10, 2018."

The draft Form 1040 allows taxpayers either to enter the standard deduction or attach Schedule A.

A draft of the instructions for Schedule A has not been released for 2018. However, some changes are apparent from Schedule A itself—for instance, the new $10,000 ceiling on state and local tax deductions.

Form 1040 proposed for 2018

As proposed, Form 1040 for 2018 would use a "building block" approach—that is, there would be a basic Form 1040 to which certain taxpayers would supplement with additional "schedules" if needed. The IRS previously released draft versions for Form 1040 and Schedules 1 - 6 for the tax year 2018.

New Jersey: Corporation Business Tax Law Changes Enacted

July 9, 2018

In New Jersey, tax legislation enacted in July 2018 includes changes to the "corporation business tax" laws.

Among these new tax law measures are the following:

- A temporary "surtax" on corporation business taxpayers at a rate of 2.5% (in general for 2018 and 2019) and at a rate of 1.5% (in general for 2020 and 2021), with the surtax expiring beginning in 2022
- Measures addressing the New Jersey tax treatment in response to certain federal tax law changes enacted in December 2017, including provisions relating to the dividends-received deduction, revised "treaty exception" to addback rules, interest deduction limitation, and IRC section 199A deduction
- Market-based sourcing for service receipts
- Rules for mandatory unitary combined reporting
- Penalty relief measures for underpayments of tax relating to retroactive tax changes
- Conformity to federal tax law for research credit purposes

Read a July 2018 report [PDF 93 KB] prepared by KPMG LLP

IRS Releases Draft Form 1040 Schedules for 2018 Tax Year

July 2, 2018

The IRS has provided in connection with a draft version of Form 1040, "U.S. Individual Income Tax Return," a series of "schedules" to be filed by certain individuals for tax year 2018.

The draft version of Form 1040 originally appeared with a "watermark" date of June 29, 2018, but subsequently was replaced with a draft version showing a watermark date of July 31, 2018.

The draft versions of the following schedules to be filed with Form 1040 for tax year 2018 were posted by the IRS, and all originally showed a "watermark" date of June 29, 2018, but subsequently were replaced with draft versions showing a watermark date of July 31, 2018.

- Schedule 1 [PDF 106 KB]
  Additional Income and Adjustments to Income
- Schedule 2 [PDF 94 KB] Tax
- Schedule 3 [PDF 94 KB] Non-refundable Credits
- Schedule 4 [PDF 95 KB] Other Taxes
- Schedule 5 [PDF 96 KB] Other Payments and Refundable Credits
- Schedule 6 [PDF 91 KB] Foreign Address and Third Party Designee

KPMG observation

Certain items on these draft schedules appear on the version of Form 1040 that was filed for the 2017 tax year.

June 2018

IRS Releases Draft "Streamlined" Form 1040 for 2018 Tax Year

June 29, 2018

The IRS released a draft version of Form 1040, "U.S. Individual Income Tax Return," and announced plans for a streamlined—that is, shorter and simpler—Form 1040 to be filed by individuals for tax year 2018.

The draft version of Form 1040 [PDF 63 KB] originally was released with a "watermark" date of June 29, 2018, but subsequently was replaced by a draft version of Form 1040 showing a watermark date of July 31, 2018.

According to a related IRS release—IR-2018-146—the new Form 1040 would be about half the size of the current version, and would replace the current Form 1040 as well as the current versions of Form 1040A and Form 1040EZ. The IRS stated it intends to finalize the new Form 1040 "over the summer."

As explained in the related IRS release, the new Form 1040 uses a "building block" approach, and would be supplemented with additional schedules if needed. It is intended that taxpayers with "straightforward tax situations" would only file this new Form 1040 with no additional schedules.

The Wayfair Decision and Its Impact

June 21, 2018

Navigating U.S. Sales and Use Taxes in a Post-Quill World

For the last 26 years, remote or out-of-state sellers looked to the U.S. Supreme Court's decision in Quill v. North Dakota as guidance for sales and use tax collection. In Quill v. North Dakota, the U.S. Supreme Court ruled that a state cannot require a remote seller to collect use tax from in-state customers if the seller had no physical presence in the state (e.g., a brick-and-mortar store or employees). Years later, the increasing number of transactions through e-commerce between remote sellers and in-state customers drove states to aggressively challenge the requirement of physical presence for imposing sales and use tax. Particularly, in South Dakota v. Wayfair, the state sought to have the U.S. Supreme Court uphold a South Dakota statute imposing economic nexus standards on remote sellers without a physical presence. On June 21, 2018, the Court ruled in a 5-4 decision in favor of South Dakota, overturning the rule of physical presence set forth in Quill as "unsound and incorrect." Although the Court remanded the case to the state court for other Constitutional considerations, the Court's decision opens the door for states to require remote sellers without physical presence to collect sales and use taxes.

As physical presence is no longer required for imposing sales and use tax and the Court has not adopted a bright-line sales and use tax nexus standard, remote sellers, including foreign sellers, are facing many uncertainties in their efforts to comply with the sales and use tax law. States will likely require foreign sellers, who have no physical presence but establish economic nexus in the states, to collect and remit sales tax. Each jurisdiction may have different laws on economic nexus, adding to the compliance burden for foreign sellers. For example, South Dakota's economic nexus standard provides that any seller with sales exceeding an annual threshold of $100,000 or 200 separate transactions in the state is required to collect and remit sales tax. Many states have adopted similar standards while others have yet to adopt any economic nexus standard. One additional consideration is that foreign sellers may be able to argue that these economic nexus laws, as applied to them, discriminate or are unduly burdensome and are therefore unconstitutional. After the *Wayfair* decision, it is very likely that states will start to review their tax laws and adopt new legislation.

Next Steps

States are starting to issue guidance (e.g., Louisiana and Minnesota) but sellers will need to carefully monitor the states' responses to the Wayfair decision. Sellers should prepare for these potential new sales and use tax obligations and consider the following steps:

Step 1 - Review Existing and Post-Quill Nexus Footprint
- Existing filing obligations – consider voluntary disclosure agreements/amnesty programs
- Assess post-Quill filing obligations

Step 2 - Consider the Overall Business Implications
- Communicate with all stakeholders in the organization
- Involve legal, marketing, supply chain, technology, direct tax, finance

Step 3 - Review Product/Service Mix
- Develop taxability determinations
- Examine bundled items

Step 4 - Review and Consider Technology Needs
- What do you have and what are your options?
- Consider tax engine upgrades or outsourcing compliance processes

Step 5 - Filing Compliance and Initial Registration
- Register in new jurisdictions

Step 6 - Ongoing Compliance
- Consider how to monitor and respond to tax updates and state requests

Other Considerations

While the Wayfair decision relates to sales and use tax, it may also have effects on income tax filing obligations. Many states have adopted an economic nexus standard for corporate income tax purposes. The Wayfair decision validates the states' position that physical presence is not required to impose state income tax. To the extent that foreign sellers are not filing income tax returns in states that have economic nexus based on the position that economic nexus is unconstitutional, they will need to revisit such position and may need to accrue income tax liabilities.

In addition, foreign and domestic sellers should also consider Public Law 86-272. This law may exempt foreign and domestic sellers from filing a state income tax return, regardless of the state's economic nexus position, if its activity within the state is limited to mere solicitation of orders for the sale of tangible personal property, the orders of which are approved and filled from outside the state. It should be noted, however, that a state may argue that Public Law 86-272 does not apply to purely foreign commerce such as a foreign business selling directly into the state. For example, California has taken this view. Also, although this law may exempt foreign sellers from income-based tax, it does not exempt foreign sellers from non-income-based taxes, such as gross receipts tax, franchise tax based on net worth, and/or minimum taxes.

May 2018

Notice 2018-44: Housing Expense Limit Adjustments, Foreign Locations for 2018

May 1, 2018

The IRS today released an advance version of Notice 2018-44 providing the adjustments to the limitation on housing expenses, under section 911, for specific locations for 2018.

The adjustments are made on the basis of geographic differences in housing costs relative to housing costs in the United States—thus, providing an increased amount that a qualified individual can elect to exclude from gross income as a housing cost amount for purposes of section 911.

Notice 2018-44 [PDF 127 KB] provides that under a general limitation, a qualified individual whose entire tax year is within the applicable period is limited to maximum housing expenses of $31,170 ($103,900 x .30) for 2018. A table is included with the adjusted limitations on housing expenses for certain foreign locations (in lieu of the otherwise applicable limitation of $31,170) for 2018.

Prior incorrect notice is withdrawn, replaced

In the Internal Revenue Bulletin (dated Monday, April 23, 2018), the IRS included Notice 2018-33. However, as noted in today's release, that notice used an incorrect amount for the maximum foreign earned income exclusion to calculate the housing cost amount for 2018. Accordingly, today's release—Notice 2018-44—provides the correct amount of the maximum housing expenses and the base housing amount for 2018.

Questions?

If you have any questions about this article please reach out to your KPMG engagement team or the contact listed with this article.

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