EEI & AGA Executive Accounting News Flash

January 2018

Dear Colleagues:

Happy New Year and welcome to the 2017 fourth quarter edition of the Executive Accounting News Flash.

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 and 2019. This includes the leases standard which will be here next year. 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.

In this quarter's edition we summarize the impact of tax reform, the 2017 AICPA conference, recent updates at the SEC (most notably, the proposed changes to Regulation S-K) and updates to the revenue recognition and leases standards. For more detail on any of the information provided herein, please click the related links contained within or reach out to:

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Current quarter financial reporting matters

Congress Passes Tax Reform

On December 22, 2017 H.R. 1, originally known as the **Tax Cuts and Jobs Act was enacted**. Given that ASC 740, Income Taxes, requires companies to recognize the effect of tax law changes in the period of enactment, H.R. 1 is expected to significantly impact companies' accounting and reporting of income taxes.

On December 22, 2017, the SEC staff issued SAB 118 which allows companies to recognize provisional amounts when it does not have the necessary information in reasonable detail to complete its accounting for the change in tax law. In addition, the SEC issued Compliance and Disclosure Interpretation 110.02 regarding the applicability of Item 2.06 of Form 8-K with respect to reporting the impact of a change in tax rate or tax laws pursuant to the Act. See KPMG's Tax Reform Defining Issues for additional information on this topic.

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 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.

EEI and AGA filed joint comments on December 23, 2017, prior to the January 2, 2018 deadline.

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

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

Audit developments affecting financial statement preparers

SEC Names New PCAOB Members
The Securities and Exchange Commission announced the appointment of William D. Duhnke III as Chairman and J. Robert Brown, Kathleen M. Hamm, James G. Kaiser, and Duane M. DesParte as Board members of the Public Company Accounting Oversight Board (PCAOB). Duane DesParte will soon retire as Senior Vice President and Corporate Controller of Exelon Corporation, one of our member companies.

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.

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

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.

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).

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

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.

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

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.
- 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.

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.

For details on these and additional matters related to the implementation of ASC 842, please see the Resources provided below.

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

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

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. For rate regulated entities that continue to capitalize all the components of net benefit cost, the entity may need to reclassify the capitalized non-service cost components to a regulatory asset or regulatory liability.
- **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.

Projects and agenda priorities

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. 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

Inventory of Standard-Setter Activity for Potential Comment as of December 31, 2017

Organization	Status	Key Date/Event	Description
FASB	Evaluating comment letters prior to redeliberations	Fall/Winter 2017 – FASB Meeting	*Land easements practical expedient for Transition to Topic 842* Monitoring FASB meeting notices for redeliberations on Exposure Draft. On 10/25/17, EEI and AGA submitted to FASB a joint comment letter on the accounting for land easements, requesting FASB to provide appropriate transition relief if it ultimately decides to reduce or eliminate the diversity in the accounting for easements.
SEC	Reg. S-K Update – Proposed Rule	1/2/2018 – Comment Deadline	*Release No. 33-10425 – FAST Act Modernization and Simplification of Regulation S-K* EEI and AGA submitted comments on the proposed rule on 12/28/17.

Organization	Status	Key Date/Event	Description
FASB	Proposed ASU	2/5/2018 – Comment Deadline	*Leases – Targeted Improvements* The proposed ASU would simplify transition requirements and, for lessors, provide a practical expedient for the separation of nonlease components from lease components. Specifically, the amendments would: • Add an option for transition to Topic 842 that would permit an organization to apply the transition provisions of the new standard at its adoption date instead of at the earliest comparative period presented in its financial statements • Add a practical expedient that would permit lessors to not separate nonlease components from the associated lease components if certain conditions are met. This practical expedient could be elected by class of underlying assets; if elected, certain disclosures would be required. .
FASB	Initial deliberations	2017-2018 – FASB meeting to review Staff research	*Improving the Accounting for Asset Acquisitions and Business Combinations (phase 3 of the Definition of a Business project)* EEI and AGA have not yet decided whether to formally comment on the exposure draft. Monitoring future Board meetings to evaluate the scope and potential impact to the industry.
FASB/EITF	Initial deliberations	1/18/18 – EITF Meeting	*Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is Considered a Service Contract (EITF 17-A)* Monitoring January EITF meeting for possible consensus to send to FASB for drafting Exposure Draft. EEI and AGA have not yet decided whether to formally comment in the event that FASB issues an exposure draft.

Organization	Status	Key Date/Event	Description
FASB	Initial deliberations	2017/2018 – FASB Meeting	*Disclosure Framework: Disclosures—Interim Reporting* Monitoring FASB meeting notices for redeliberations, including feedback on proposed FASB Concepts Statement and summer 2017 meeting with Investor Advisory Committee. EEI and AGA have not yet decided whether to formally comment on the exposure draft. Monitoring status and issues.

Recent EEI & AGA Trainings and Other Events

EEI/AGA Fall Accounting Conference (Miami, FL)

EEI and AGA conducted their annual fall accounting conference in Miami, FL from November 12th through November 15th. The conference included breakout sessions for corporate accounting and property accounting. Topics covered include: lease standard update, SEC/FASB updates, implementation issues related to ASC 715, robotics, recent FERC audits, rate case management, electric & gas industry updates. The conference was attended by 79 individuals.

FERC Accounting and Reporting Requirements

AGA and EEI along with Deloitte held a webcast on November 8, 2017 which walked participants through an overview of the current FERC landscape, related hot topics, enforcement, an update on AFUDC and best practices related to researching FERC accounting matters.

Upcoming EEI & AGA Accounting Committee Events

Below is a summary of upcoming accounting related events through September 30, 2018 (joint AGA-EEI meetings unless indicated otherwise)

May 20 – 23, 2018	San Diego, CA	Spring Accounting Conference
June 10 - 13, 2018	Minneapolis, MN	Accounting Leadership Conference
June 10 - 13, 2018	Minneapolis, MN	Chief Audit Executive Conference
August 7 – 8, 2018	Washington, DC	FERC Accounting Liaison Committee Meeting
August 13 – 15, 2018	TBD	AGA Accounting Principles Committee Meeting
August 20 – 22, 2018	St. Louis, MO	Utility Internal Auditor's Training Course
August 20 – 23, 2018	St. Louis, MO	Introduction to Public Utility and Advanced Public Utility Accounting Training Courses
September 17, 2018	Chicago, IL	FERC Accounting & Reporting Workshop
September 24 – 26, 2018	Chicago, IL	Derivatives Accounting Workshop