EEI & AGA Executive Accounting News Flash

June 2018

Dear Colleagues:

Calendar year-end public companies have already cleared the hurdle of adopting the revenue recognition standard and the financial instruments recognition and measurement standard. However, the expanded revenue disclosures required throughout the year of adoption mean continued obstacles lie ahead. The US tax reform enacted in 2017 also continues to significantly affect companies' accounting for and reporting of income taxes and their related processes and controls.

With the effective date of the leases standard quickly approaching, the FASB is working to finalize technical corrections and amendments so companies can focus on implementing the final standards.

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

In this quarter's edition we summarize the impact of these items and more. 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

US tax reform highlights

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

Although most of the law's provisions were effective January 1, 2018, companies are still refining their estimates of how the law affects their annual effective tax rates.

Also, the Treasury department continues to issue tax technical guidance, the financial statement effects of which companies are evaluating. Further, as companies obtain, prepare or analyze additional information about facts and circumstances that existed at the enactment date, they continue to adjust balances that were recorded provisionally as of December 31, 2017 under SAB 118. Companies are reminded to update their disclosures about provisional balances as required under the SAB.

Financial reporting implications of tax reform legislation

SEC registrants planning to adjust non-GAAP financial measures and/or present pro forma financial information for the effects of the Tax Act should consider these guidelines.

- **Non-GAAP Financial Measures.** While certain adjustments to GAAP financial measures may be permitted, depending on a registrant's facts and circumstances, adjustments need to be balanced (i.e. include revenue and expense impacts) and consider not only the change in the corporate tax rate but also other impacts (e.g. the deemed repatriation transition tax). Adjustments that 'normalize' the tax – i.e. adjustments that apply the new tax rate to periods before enactment may not be appropriate because they may not reflect actual performance due to different tax strategies and changes in judgments or tax assertions that might have been employed had the new rate been in effect.
- **Pro Forma Financial Information.** A registrant that elects to reflect the impact of the Tax Act in pro forma financial information as a material event under Rule 11-01(a)(8) of Regulation S-X is encouraged to discuss its specific facts and circumstances with the SEC staff on a pre-filing basis to determine the appropriateness of those pro forma adjustments.

Resources: KPMG's Q&A, Tax reform -- Supplement to KPMG's Handbook, Income Taxes; FASB Staff Q&As; ASU 2018-02; SAB 118; Center for Audit Quality (CAQ) SEC Regulations Committee March 2018 meeting highlights

Observations on the effects of adopting the revenue recognition standard

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

Adoption method insights

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

- the amount by which applying ASC 606 affects each financial statement line item in the current period; and
- the amount and reason for the significant changes between the reported results under ASC 606 and those that would have been reported under legacy US GAAP (ASC 605, *Revenue Recognition*).

Resources: KPMG's webpage on Revenue, KPMG's executive view, Early thinking in adopting ASC 606

Management's discussion and analysis (MD&A) disclosures

In addition to the required transition disclosures, many companies are providing additional information in MD&A about the effect of the adoption on prior periods. This presentation is considered a supplemental presentation – not non-GAAP or pro forma financial information. A registrant is permitted to include comparable prior periods under ASC 606 to facilitate comparability of MD&A disclosures as long as it follows certain guidance in the supplemental presentation:

- the discussion is not more prominent than the historical MD&A discussion;
- the discussion is limited to only those items for which the registrant can determine the effects (e.g. a registrant should not present a supplemental measure of gross profit or operating income unless the affected costs can be appropriately adjusted);
- the income statement line items presented are limited to those that would have been affected – a registrant should not present a full income statement; and
- the registrant's discussion may address net income for the prior periods if the registrant is able to determine the effects on all affected income statement line items.

Alternatively, a registrant may present the 2018 results determined under legacy US GAAP similar to what is required by ASC 606 in the notes to the financial statements. This option would be permitted in 2018 only, the year of adoption, and the registrant would need to:

- provide disclosures comparable to those required in the notes to the financial statements under ASC 250, *Accounting Changes and Error Corrections;*
- display the ASC 606 results prominently; and
- limit the discussion about the ASC 605 amounts to comments that enhance an investor's understanding of comparability.

Regardless of whether the registrant chooses this option, it should disclose assumptions or practical expedients used.

Resources: CAQ SEC Regulations Committee March 2018 meeting highlights

Control changes with implementation

Companies that have materially changed their internal controls over financial reporting (ICFR) are required to disclose the changes in their interim and annual filings. Though not required, a number of companies have disclosed the effect of adoption on processes and controls even when management did not believe those changes were material.

When considering whether to disclose internal control changes, it may be helpful to think about the controls associated with adoption in two groups: 'one-time' controls put in place to adopt and transition to the new standard, and 'ongoing' controls needed to account for current and future transactions under ASC 606.

Resources: KPMG's webpage on Revenue, KPMG's executive view, Control changes with ASC 606 implementation

SEC staff comment letters on early adopters

SEC staff comment letters on the 2017 filings of some early adopters provide helpful insight into matters that are important to the SEC staff. The SEC staff asked most early adopters for additional or expanded disclosures in future filings about disaggregation of revenue and performance obligations.

Resources: KPMG's webpage on Revenue, KPMG's executive view, SEC comments on ASC 606 early adopters

New Standards and Guidance

Leases standard effective date draws near

The leases standard takes effect for public companies in 2019 and companies are beginning to identify more detailed implementation issues. Public companies have raised questions about whether it is appropriate to use a recognition threshold below which they would not recognize lease assets and liabilities.

Understanding the short-term lease exemption

A short-term lease under the leases standard has a 'lease term' of 12 months or less at the commencement date, and does not include a purchase option on the underlying asset that the lessee is reasonably certain to exercise.

Although short-term leases are in the scope of the leases standard, a *lessee* can elect, by class of underlying asset, not to apply the balance sheet recognition requirements of the standard – i.e. elect not to recognize a right-of- use (ROU) asset or lease liability for short term leases. Lease cost is recognized on a straight-line basis over the lease term. This is how operating leases are accounted for under current US GAAP. A lessee that elects this exemption must disclose in its annual financial statements:

— that it elected the exemption and to which classes of underlying assets the exemption applies;

— lease cost for leases subject to the exemption with a lease term longer than 30 days; and

— undiscounted short-term lease obligations if that amount is significantly different from its short-term lease cost for the most recent annual period.

Because electing the exemption keeps short-term leases subject to the company's election off the balance sheet, a company will have lower lease assets and lease liabilities and can generally avoid making certain judgments related to recognition and measurement (e.g. determining a discount rate).

However, a company may decide that electing the exemption is not in its best interest, likely for operational reasons. For example, because of the disclosures required for unrecognized short-term leases, specific processes and controls that are different from those used for the company's other leases may be needed to account for short-term leases. And if a company has invested in a new leasing IT system or is implementing new processes and controls for its operating leases, it may prefer to run all of its leases, including short-term leases, through the same system and processes, particularly if the balance sheet effect of electing or not electing the exemption is minor.

Using recognition thresholds under the leases standard

The FASB observed that in addition to accounting for some leases at a portfolio level, companies would likely be able to reduce their costs of applying the leases standard by adopting reasonable thresholds below which they would not recognize lease assets and lease liabilities. The FASB stated that a company may adopt a practice of using a recognition threshold under the leases standard consistent with its accounting policies to use thresholds in other areas of US GAAP – e.g. when determining whether to capitalize purchases of property, plant and equipment (PP&E).

Many companies have expressed a desire to establish a recognition threshold under which they would not recognize ROU assets or lease liabilities. Some of these companies have asked whether they would still need to include these leases in their required lease disclosures under the leases standard.

While applying a recognition threshold generally will be acceptable, setting it at an appropriate level may require substantial judgment, and it generally would *not be appropriate* for a company to:

— default to its PP&E capitalization threshold;

— evaluate the effect of the threshold based on the net effect on the balance sheet (ROU assets minus lease liabilities); or

— ignore the effect of the threshold on financial statement disclosures.

It may be helpful for companies to evaluate the lease liability first when establishing the recognition threshold. We expect that it would be relatively rare for a company to conclude that its capitalization threshold for ROU assets is less than its recognition threshold for lease liabilities. Further, companies that are considering a recognition threshold should consider how using that threshold would affect their lease disclosures.

Resources: KPMG's Handbook

Changes to hedge accounting

In August 2017, 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, which is effective for public companies in 2019, 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 effects of the hedged item.

The standard also permits hedge accounting for certain strategies that are not currently permitted, 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. It introduces new alternatives permitting companies to reduce the risk of material error corrections if they misapply the shortcut method.

Companies may early adopt the hedge accounting 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.

In March, the FASB discussed the status of, and issues arising from, implementation activities. The Board agreed to add two projects to its agenda.

- A narrow project about the 'last-of-layer method' – specifically about how to account for basis adjustments and multiple-layer hedging strategies. The last of layer method permits a company to designate a fixed amount of a closed portfolio of prepayable financial assets as the hedged item in a fair value hedge of interest rate risk if the company expects the designated amount to remain outstanding at the end of the hedge term.
- A Codification improvement project to clarify a company's ability to change the hedged risk and/or the hedged forecasted transaction during the term of the hedge relationship.

Resources: Issues In-Depth, Hedging – Targeted Improvements; ASU 2017-12

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Projects and Agenda Priorities

Emerging Issues Task Force (EITF) activities

On June 27, the FASB ratified the EITF's final consensus that a customer in a cloud computing arrangement (CCA) (i.e. a hosting arrangement that does not grant the customer a license to the hosted software) should capitalize implementation costs that it incurs if the customer would capitalize those same costs under the internal-use software guidance for an arrangement that is a software license. The FASB expects to issue a final ASU early in the third quarter.

The EITF's next meeting is September 27.

Resources: KPMG's Defining Issues, EITF reaches a final consensus on implementation costs for cloud computing and a consensus-for-exposure; Proposed ASU

Targeted improvements to related party guidance for variable interest entities (VIEs)

The FASB proposals also will require indirect interests held through related parties in common control arrangements to be considered on a proportional basis when determining whether fees paid to decision makers and service providers are variable interests (decision-making fee guidance). The amendments will be effective for public companies for annual and interim periods in fiscal years beginning after December 15, 2019, and will be applied retrospectively with a cumulative-effect adjustment to retained earnings at the beginning of the earliest period presented. For all other entities, the amendments will be effective for fiscal years beginning after December 15, 2020. Early adoption will be permitted.

The FASB decided not to amend the VIE related party guidance for determining the primary beneficiary of a VIE. Instead, the Board added a project to its research agenda to determine whether amendments to the VIE-related party guidance may be required after the effective dates of the private company accounting alternative and the amendments to the decision-making fee guidance.

The FASB has completed its redeliberations and expects to issue a final ASU in the third quarter.

Recent EEI & AGA Trainings and Other Events

EEI & AGA Spring Accounting Conference (San Diego, CA)

EEI and AGA conducted their annual spring accounting conference in San Diego, CA from May 20th through May 23rd. The conference included breakout sessions for corporate accounting, accounting standards, budgeting & financial forecasting and property accounting. Topics covered include: lease standard update, SEC/FASB/FERC updates, robotics & automation, tax reform, cloud computing, implementation issues related to ASC 715, robotics, smart grid, electric & gas industry updates. The conference was attended by nearly 220 members.

EEI & AGA Accounting Leadership and Chief Audit Executive Conference (Minneapolis, MN)

EEI and AGA conducted their annual accounting leadership and chief audit executives conference in Minneapolis, MN from June 10th through June 13th. Topics covered include: tax reform, FASB/SEC/PCAOB update, FERC update, people skills, perspectives of Wall Street, fraud, cybersecurity and data & analytics. The conference was attended by over 100 Chief Accounting Officers and Chief Audit Executives.

Upcoming EEI & AGA Accounting Committee Events

Below is a summary of upcoming accounting related events through December 31, 2018 (joint AGA-EEI meetings unless indicated otherwise)

August 7 – 8, 2018	Washington, DC	FERC Accounting Liaison Committee Meeting
August 13 – 15, 2018	Newport, RI	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 6 – 7, 2018	Dallas, TX	Lease Accounting Training
September 17, 2018	Chicago, IL	FERC Accounting & Reporting Workshop
September 24 – 26, 2018	Chicago, IL	Derivatives Accounting Workshop
November 11-14, 2018	San Antonio, TX	Fall Accounting Conference
November 14-15, 2018	San Antonio, TX	Property Accounting and Depreciation Training Seminar