

Considerations For Financial Disclosures After Tax Reform

By **Laura Richman, Robert Gray and Michael Hermsen**

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On Dec. 22, 2017, the U.S. Securities and Exchange Commission announced that the staff of its Office of the Chief Accountant and its Division of Corporation Finance issued Staff Accounting Bulletin No. 118,[1] which provides guidance on the necessary disclosures of the accounting impacts of the Tax Cuts and Jobs Act, and Compliance and Disclosure Interpretation 110.02,[2] which addresses when a current report on Form 8-K or a subsequent periodic report may be used to report the impact of the tax act on deferred tax assets.

SAB 118

While Financial Accounting Standards Board Accounting Standards Codification Topic 740, Income Taxes (ASC Topic 740) addresses the recognition of deferred tax liabilities and deferred tax assets for future tax consequences in certain circumstances and accounting for income taxes for certain changes in tax law or tax rates, ASC Topic 740 does not address certain circumstances that may arise for some public companies in accounting for the income tax effects of the tax act. The SEC staff issued SAB 118 “to address situations where the accounting under ASC Topic 740 is incomplete for certain income tax effects of the Tax Act upon issuance of an entity’s financial statements for the reporting period in which the Tax Act was enacted.” In particular, SAB 118 sets forth the staff’s views on the application of ASC Topic 740 in the reporting period that includes Dec. 22, 2017, which is the date the tax act was signed into law.

SAB 118 establishes a three-part procedure for companies to follow when accounting and reporting the income tax effects of the tax act in financial statements that include a reporting period in which the tax act was enacted:

1. Reflect the income tax effects of the tax act in which the accounting under ASC Topic 740 is complete on a nonprovisional basis;
2. Report provisional amounts for those specific income tax effects of the tax act for which the accounting under ASC Topic 740 is incomplete but a



Laura Richman



Robert Gray



Michael Hermsen

reasonable estimate can be determined; and

3. Continue to apply ASC Topic 740 based on the provisions of the tax laws that were in effect immediately prior to the enactment of the tax act for any specific income tax effects of the tax act for which a reasonable estimate cannot be determined.

When a company is unable to determine a reasonable estimate for any income tax effects, it must report provisional amounts in the first reporting period in which a reasonable estimate can be determined. SAB 118 provides a number of examples of how its guidance should be applied.

SAB 118 uses the concept of a “measurement period” that begins in the reporting period that includes the tax act’s Dec. 22, 2017, enactment date and ends when an entity has obtained, prepared and analyzed the information that is needed in order to complete the accounting requirements under ASC Topic 740. SAB 118 recognizes that during the measurement period, an entity may need to make changes in subsequent reporting periods based on facts and circumstances that existed when the tax act was enacted and that, if known, would have affected the income tax effects initially reported as provisional amounts. However, income tax effects of events unrelated to the tax act should not be reported as measurement period adjustments. Any provisional amounts or adjustments to provisional amounts included in an entity’s financial statements during the measurement period should be included in income from continuing operations as an adjustment to tax expense or benefit in the reporting period the amounts are determined. The SEC staff stated that in no circumstances should the measurement period extend beyond one year from the enactment date.

SAB 118 specifies that financial statement disclosures should provide information about the material financial reporting impacts of the tax act for which the accounting under ASC Topic 740 is incomplete, including:

- Qualitative disclosure of the income tax effects of the tax act;
- Disclosure of items reported as provisional amounts;
- Disclosure of existing current or deferred tax amounts for which the income tax effects have not been completed;
- The reason why the initial accounting is incomplete;
- The additional information that is needed to be obtained, prepared or analyzed in order to complete the accounting requirements;
- The nature and amount of any measurement period adjustments recognized during the reporting period;
- The effect of measurement period adjustments on the effective tax rate; and
- When the accounting for the income tax effects of the tax act has been completed.

CD&I 110.02

Item 2.06 of Form 8-K requires the filing of a current report on Form 8-K “[i]f the registrant’s board of directors, a committee of the board of directors or the officer or officers of the registrant authorized to take such action if board action is not required, concludes that a material charge for impairment to one or more of its assets, including, without limitation, impairments of securities or goodwill, is required under generally accepted accounting principles applicable to the registrant.”

CD&I 110.02 clarifies that the remeasurement of a deferred tax asset to incorporate the effects of the tax act does not trigger an obligation to file under Item 2.06 of Form 8-K because such remeasurement does not constitute an impairment under ASC Topic 740. The CD&I 110.02 further makes clear that a company employing the “measurement period” approach contemplated by SAB 118 that concludes that an impairment has occurred due to changes resulting from the enactment of the tax act may rely on the instruction to Item 2.06 and disclose the impairment, or a provisional amount with respect to that possible impairment, in its next periodic report.

Practical Considerations

For reporting periods within their measurement period, companies should consult with their accountants to determine the extent to which they will:

- Know specific income tax effects of the tax act;
- Be able to make reasonable estimates of specific income tax effects of the tax act; or
- Not be able to know or make reasonable estimates for specific income tax effects of the tax act.

Based on this information, companies should prepare their financial statements in accordance with SAB 118, including the narrative explanations necessary to provide information about the material financial reporting impacts of the tax act.

While developing language to explain the extent to which their reports contain provisional estimates and the extent to which there was not sufficient information upon which to make reasonable estimates, companies may want to expressly raise the possibility that adjustments might be needed in subsequent financial statements once further information becomes available.

Companies should consider their approach for disclosing information about the accounting impact of the tax act before the filing of their financial statements with the SEC. For example, some companies may find it appropriate to include a discussion of the accounting issues under the tax act in their earnings releases in order to enhance the understanding of the results being presented.

Even though a Form 8-K may not be required under Item 2.06 of Form 8-K, there could be other reasons why a company may elect to file a Form 8-K to report the impacts of the tax act. For example, to avoid potential issues under Regulation FD or Section 10(b) of the Securities Exchange Act of 1934, companies may want to consider generally disclosing information, even if it is not final or complete, when it is available so that they are freer to respond to inquiries from investors or other interested parties. To address concerns about making selective disclosure, companies should prepare their investor relations departments for questions that may arise before financial statements have been filed concerning the accounting impacts of the tax act. In addition, companies should be aware that a Form 8-K must be furnished under Item 2.02 to report the disclosure of any material nonpublic information regarding a company’s results of operations or financial condition for a completed quarterly or annual fiscal period, not just for an earnings release. An Item 2.02 Form 8-K would be required even if the only information disclosed is the accounting impact of the tax act for a completed period, even if full financial statements are not disclosed. Therefore, disclosure of the accounting impacts of the tax act could trigger multiple Form 8-K reports if material nonpublic disclosures are made at different times.

Finally, companies considering disclosing information in addition to that required by ASC Topic 740 and

SAB 118 should consider whether such information is a non-GAAP financial measure triggering the requirements of Item 10(e) of Regulation S-K and/or Regulation G, as applicable.

Laura D. Richman is a counsel at Mayer Brown LLP in the firm's Chicago office. Robert F. Gray Jr. is a partner in the firm's Houston office. Michael L. Hermsen is a partner in the firm's Chicago office.

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[1] Available at <https://www.sec.gov/interps/account/staff-accounting-bulletin-118.htm>.

[2] Available at <https://www.sec.gov/divisions/corpfin/guidance/8-kinterp.htm#110.02>.

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