ACCOUNTING BRIEF
ASU 2023-09 Planning Considerations

November 2024

SUMMARY

Accounting Standards Update (ASU) 2023-09, *Income Taxes (Topic 740): Improvements to Income Tax Disclosures* (ASU 2023-09), is effective for public business entities generally beginning in calendar year 2025 and other entities one year later. ASU 2023-09 is intended to help investors better assess how an entity's operations and related income tax risks affect the entity's income tax rate and prospects for future cash flows. To achieve these objectives, the ASU requires expanded disclosures in the notes to the financial statements, including the use of consistent categories and greater disaggregation of information in the effective tax rate reconciliation and income taxes paid information disaggregated by jurisdiction.

This article identifies certain key planning considerations as entities prepare to comply with the new disclosure requirements.

1. BACKGROUND

On December 14, 2023, the Financial Accounting Standards Board (FASB) issued ASU 2023-09. The amendments in this ASU address investor requests for more transparency about income tax information through improvements to income tax disclosures primarily related to the rate reconciliation and income taxes paid information. ASU 2023-09 is effective for public business entities for annual periods beginning after December 15, 2024 (or 2025 for calendar-year entities), and one year later for all other business entities.

This Accounting Brief is primarily focused on the planning considerations for public business entities, given the earlier effective date of ASU 2023-09 for these entities and the fact that only public business entities are required to provide the expanded quantitative rate reconciliation disclosures. However, many of the considerations described in this paper are also applicable to other entities, as they will need the underlying quantitative information in order to provide the qualitative rate reconciliation disclosures required under the ASU.

1.1 Requirements of ASU 2023-09

For each annual reporting period, ASU 2023-09 will require a public business entity to disclose specific categories, and, when certain thresholds are met, present additional disaggregated data within its reconciliation between the amount of reported income tax expense (or benefit) from continuing operations and the amount computed by multiplying the income (or loss) from continuing operations before income taxes by the applicable statutory federal (national) income tax rate of the jurisdiction (country) of domicile.

To enable users of financial statements to understand the nature and magnitude of factors contributing to the difference between the effective tax rate and the statutory tax rate, a public business entity will also be required to disclose a tabular reconciliation, using both percentages and reporting currency amounts, separately disclosing the following specific categories:

- State and local income tax, net of federal (national) income tax effect
- Foreign tax effects
- Effect of changes in tax laws or rates enacted in the current period
- Effect of cross-border tax laws
- Tax credits
- Changes in valuation allowances
- Nontaxable or nondeductible items
- Changes in unrecognized tax benefits.

ASU 2023-09 also requires further disaggregation of individual reconciling items that are equal to or greater than a 5% quantitative threshold of an amount computed by multiplying pretax income (loss) from continuing operations by the applicable federal (national) rate. Where the 5% threshold applies, items should be disaggregated by nature within the cross-border tax laws, tax credits, and nontaxable or nondeductible items categories, as well as by both jurisdiction and nature within the foreign tax effects category. Other items that do not appear within the above bullet point list that are equal to or exceed the 5% threshold should also be disclosed separately. For example, consider Entity XYZ, a U.S.-domiciled corporation with 20X5 income from continuing operations before income taxes of $3,500,000. Based on the current U.S. federal corporate tax rate of 21%, the quantitative threshold for separately disclosing rate reconciliation categories that affect Entity XYZ's effective tax rate is $36,750 (or $3,500,000 x 21% x 5%). This calculates to 1.05% of its pretax income from continuing operations ($36,750 / $3,500,000).

ASC 740-10-50-12A includes other quantitative disclosure requirements, while additional qualitative disclosure requirements are specified in ASC 740-10-50-12B through 50-12C. ASU 2023-09 also will require disclosures of income taxes paid, net of refunds received, disaggregated by federal, state and foreign jurisdictions together with income taxes paid, net of refunds, for individual jurisdictions that comprise 5% or more of total income taxes paid. Refer to our article *ASC 740: FASB releases ASU 2023-09: Improvements to Income Tax Disclosures* for further information about the new disclosure requirements.

2. TRANSITION CONSIDERATIONS

To aggregate the information needed to comply with the new disclosure requirements, some reporting entities may need to update their recordkeeping processes and accounting systems to include additional data elements. A data element is a unit of data that includes either a unique name or identifier, or a clear description of what it represents. In addition, it may include a format or type of data (e.g., numeric). For example, a data element in this context could be "Payee," "Type of Tax" or "Jurisdiction."

Entities will also need to consider whether related processes and controls require further enhancements to ensure timely, complete and accurate reporting of information presented in the notes accompanying the financial statements.

For those reporting entities that already have robust databases (including data accuracy and governance processes), processes, and controls over the tax provision and disclosures, adoption of ASU 2023-09 may require fewer changes to ensure compliance with the new reporting requirements. For other entities, adoption of ASU 2023-09 may require more effort and resources. The number and scope of process and control changes will vary by entity. The following table identifies certain factors that may indicate the extent of changes needed to comply with the new disclosure requirements:

More changes	Fewer changes
Manual tax provision processes	Corporate tax software solutions supporting the preparation of tax provisions
Multiple subsidiaries and large number of tax jurisdictions	Few subsidiaries and limited number of tax jurisdictions
Entities with highly complicated tax provisions	Entities with less complicated tax provisions (e.g., no uncertain tax positions, tax credits, foreign income tax)

More changes	Fewer changes
Using a blended state or foreign tax rate to prepare the tax provision	Preparing the state and foreign tax provision on a jurisdiction-by-jurisdiction basis

The following example illustrates a common situation that may require changes to the data elements accumulated within an entity's systems (databases) or in other processes and controls to comply with the enhanced rate reconciliation and income taxes paid disclosure requirements of ASU-2023-09:

Example 2-1: Blended foreign and state income tax rates

Entity A is a U.S.-based SEC registrant and taxpayer with domestic activities throughout all 50 states and foreign activities in three countries. Historically, Entity A has prepared its income tax provision and related disclosures for financial reporting purposes using blended foreign and state tax rates. This approach was deemed sufficient to produce the information needed to prepare its financial statements in accordance with GAAP and to comply with its SEC filing deadlines. Entity A has additional time after year end to compute the foreign and state tax information on the more precise jurisdiction-by-jurisdiction basis and to finalize its federal, state, and foreign income tax returns.

Historically, the return to provision adjustments, which reflect the differences between the amounts estimated within the financial statements and the tax returns, have been minimal and have been reflected in the subsequent period. Further, no material findings were identified from audits performed by the applicable tax authorities. Therefore, prior to the adoption of ASU 2023-09, Entity A concluded that its practice of using blended foreign and state tax rates for financial reporting purposes, resulted in a materially correct income tax provision and disclosures.

However, after considering the amendments in ASU 2023-09, Entity A concludes that changes are needed to its processes and controls to comply with the new disclosure requirements. That is because Entity A's current processes that use blended rates to calculate its foreign and state taxes for financial reporting purposes, would not provide the more detailed information needed to generate both:

- The qualitative disclosures about the jurisdictions that make up the majority (i.e., greater than 50%) of the effect of the state and local income taxes category on the entity's overall effective tax rate
- The further disaggregated foreign tax disclosures, either by nature or jurisdiction

Entity A also concludes that changes to its current processes can improve the efficiency with which it will be able to generate the information needed to comply with the new disaggregated income taxes paid disclosures of ASU 2023-09.

Many entities may determine that their processes and controls, which historically have produced materially accurate income tax disclosures, may no longer be sufficient and capable of producing complete and accurate information to comply with the disclosures required by ASU 2023-09. Public business entities should begin to evaluate their current state of preparedness to adopt the new disclosure requirements, and, as applicable, develop their plans to remediate any findings or gaps in advance of the effective date.

We recommend the following four broad steps to approach this evaluation:

1. Materiality considerations
2. Evaluate current state and identify potential gaps
3. Develop solutions to address the gaps
4. Implement and operate the solutions

Steps 1 through 3, as well as some Step 4 considerations, are discussed further below.

2.1 Materiality considerations

As more fully discussed in Section 1.1, ASU 2023-09 requires specific quantitative disclosures of the eight categories specified in ASC 740-10-50-12A(a) and further disaggregation of individual reconciling items that are equal to or greater than a 5% quantitative threshold.

When the FASB exposed the amendments in ASU 2023-09 for comment, several stakeholders requested that the Board:

1. Clarify whether (and how) materiality should be considered when evaluating whether reconciling items that meet the quantitative threshold are required to be disclosed
2. Include guidance related to materiality in ASC 740 on income tax disclosures, noting that the amendments in the proposed ASU were unclear on whether an entity would be required to separately disclose each of the eight categories specified in ASC 740-10-50-12A(a) regardless of materiality

In response to this feedback, the FASB included clarifying statements in the Basis for Conclusions to ASU 2023-09.

With respect to item (1) above, in paragraph BC22, the Board reminded stakeholders about the guidance in ASC 105-10-05-6, which states that “the provisions of the Codification need not be applied to immaterial items,” is applicable to the amendments in ASU 2023-09, as it is to all Codification guidance. Therefore, the amendments on the disclosure of reconciling items by specific categories with further disaggregation of reconciling items based on the application of a quantitative threshold do not apply to immaterial items. That is, an entity does not need to separately disclose the required specific categories or reconciling items if they are immaterial, even if the quantitative threshold is met.

With respect to item (2) above, paragraph BC24 states in part that the Board “decided not to add a discussion of materiality to the guidance in Topic 740 because the materiality guidance in paragraph 105-10-05-6 applies to all Topics. The Board was concerned that replicating the materiality guidance in some Topics and not others could lead to unnecessary confusion and potential inconsistency in practice.”

RSM COMMENTARY: When assessing the concept of materiality and determining the level of detail to be disclosed in accordance with ASU 2023-09 to keep the overall financial statements from being misstated or misleading, reporting entities should focus on the total mix of information from the perspective of a reasonable investor. To be consistent with the concept of materiality, this assessment must be objective and should take into consideration all relevant facts and circumstances, including both quantitative and qualitative factors. The SEC staff has repeatedly commented that a materiality analysis is not a mechanical exercise, nor should it be based solely on a quantitative analysis.

2.2 Evaluate current state and identify potential gaps

This step consists of reviewing the existing data elements, processes and controls to determine whether any changes are needed to generate the disclosures required under ASU 2023-09. To the extent that certain data elements are not available from the current systems (databases), processes and controls, those elements should be identified as “gaps” for future evaluation. The gaps that could result in a material misstatement or omission of information required to be disclosed under ASU 2023-09 should be incorporated into a detailed workplan to bridge (or remediate) the gaps before the effective date of ASU 2023-09.

Example 2-1 highlights a sample of system or process enhancements that may be needed to obtain the detailed information required under ASU 2023-09.

2.2.1 Transactional data

Transactional data consists of the data elements that are maintained in the respective subledger, general ledger or other source systems used by entities to prepare the income tax provision and related disclosures. Entities should perform a detailed review of the transactional data to determine whether any key data elements necessary to comply with the disclosures required under ASU 2023-09 are missing. Any significant data gaps that are identified should be added to the entity’s list of items that require remediation (or a detailed solution).

When assessing the relevance and completeness of transactional data, entities should also validate whether the information is subject to appropriate processes and controls to ensure its accuracy.

Additional questions that may be asked to identify potential gaps relating to transactional data include, but are not limited to:

- What are the key (or critical) data elements within the transaction data and are such elements currently included in the relevant systems? For example:
  - Are state and foreign taxes appropriately labeled by jurisdiction?
  - Are tax credits, cross-border tax laws and uncertain tax positions labeled as such within the transactional data that is aggregated in the general ledger systems?
- What processes and controls are in place to ensure data accuracy across systems?
  - Are there robust processes and controls over the data inputs and outputs from the systems?

- Are there periodic reviews of data quality (not only at point of input, but as it travels through the systems)?

2.2.2 Closing processes and procedures

Entities should reconsider their financial statement close processes, procedures and related controls, specifically as they relate to how the ASU 2023-09 relevant transactional data is or will be recorded, transferred between reporting systems, and aggregated into the income tax provision and related financial statement disclosures. As part of this analysis, entities should ask, among other questions:

- Can we (or will we) be able to reconcile between the income tax provision and related disclosures to the supporting transactional data? Does (or will) this reconciliation require manual procedures or is it fully automated?
- Are any changes needed to the current reporting and data aggregation processes, systems and controls to properly present the expanded effective income tax rate reconciliation and income taxes paid information in accordance with the ASU 2023-09 disclosure requirements?
- Are the current processes, systems and controls designed and operating effectively to ensure the reliability of the disaggregated data required by the ASU 2023-09 disclosures? If not, what steps are necessary to accomplish this objective and when (and by whom) will these procedures be completed to ensure timely compliance with the new reporting requirements?

2.3 Develop solutions to address the gaps

Developing a solution to address the significant gaps identified in Steps 1 and 2 is the next step. Developing the plan (or solution) includes several steps and requires buy-in across the organization, participation from many cross-functional teams, and an understanding of the requirements including any dependencies. For example, modifying transaction data (data elements) may require a technology solution (e.g., a system update), a process update or updated controls. It is therefore important for entities to develop workstreams that address each part or phase of the plan, as well as any dependencies. The solution should be developed by a cross-functional team and reviewed by appropriate levels of management and those charged with governance.

2.3.1 Completeness and accuracy of underlying data

Potential solutions to address gaps related to the completeness and accuracy of underlying data may be a simple, such as changing the data input processes into the accounting or tax system to include additional data points and perform a review of such data points. Alternatively, the solution may be more complicated and require either an upgrade or change to existing technology, or even conversion to a new technology. For example, adding a data element to an entity's accounting system to capture data related to tax credits may involve one or more of the following:

- Adding a field to the system (a technology solution)
- Using an existing blank field to enter the required data (a process change)
- Implementing periodic reviews of the data outputs (updated controls)

Additionally, when implementing any changes, entities should ensure the accuracy of all of the data elements. Entities should re-evaluate the processes and controls in place to ensure that the key data elements are accurate and reconcilable to supporting documentation.

In addition, entities should consider their existing data governance practices to ensure complete, accurate and consistent tax data. Such data governance practices should include periodic reviews of data inputs and outputs and timely remediation of any discrepancies or findings.

2.3.2 Technology changes

The following are examples of questions to be answered to be able to close the technology related gaps:

- Do current software programs need to be modified, upgraded, or replaced? If so, what is the scope of the change(s) needed?
- Can multiple general ledger systems be consolidated into one?
- Can tax provision software help with some of these issues?

The answers to these questions need to be carefully considered in terms of cost and projected benefit, timing, and resources needed. More than one alternative should be considered to develop the appropriate solution. Technology solutions take time, so entities should plan ahead to ensure there is sufficient time for compliance. Additionally, entities must ensure that appropriate IT general controls are considered when designing and implementing these changes.

2.4 Implement and operate the solutions

Although the focus of this publication is on planning considerations, included below are some reminders for reporting entities to consider as they finalize their potential solutions and begin to implement new processes and controls to adopt the new disclosure requirements of ASU 2023-09.

2.4.1 Process documentation

Process documentation is important to ensure smooth execution of processes and controls. Proper documentation helps employees to understand their roles and responsibilities, standardize processes, and maintain consistency when different employees are performing the same task. Further, maintaining this documentation, including remediation of any gaps, is necessary to provide appropriate evidence to internal and external auditors supporting the effective adoption and implementation of ASU 2023-09.

2.4.2 Disclosure documentation

During the project implementation phase, it is important for entities to maintain detailed documentation of the assumptions, methodologies and calculations used to prepare and support the disclosures. Clear recordkeeping and audit trails are necessary both for internal and external reporting purposes.

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