Financial reporting briefs

What you need to know about this quarter’s accounting, financial reporting and other developments

March 2022
Accounting update

Accounting and financial reporting implications of the war in Ukraine

Russia’s invasion of Ukraine and the resulting sanctions are having far-reaching effects on trade, capital markets and company operations, and companies need to focus on the accounting and financial reporting implications of the war and its ripple effects. Our thoughts are with the people of Ukraine who are dealing with the humanitarian catastrophe unfolding in their homeland.

While most companies likely have limited direct exposure to the Russian and Ukrainian economies, the indirect effects of the war and the impact of sanctions and other actions on Russian entities and their affiliates are likely to have an impact on accounting and reporting matters. In some cases, this impact may be meaningful. The indirect effects may include increases in oil and gas prices and supply disruptions for certain raw materials and component parts.

Indicators of impairment likely exist for entities that have long-lived assets (asset groups), goodwill, equity method investments or certain financial assets measured at amortized cost in Ukraine or Russia or have activities in those countries or cash flows that are dependent on activity in those countries. These entities will need to consider how the war, or changes in their business strategy in Russia, change their projections of future cash flows and other significant assumptions (e.g., discount rates) used in testing for impairment or determining fair value. In certain cases, companies may conclude that the assets previously classified as held and used may now be classified as held for sale or abandoned.

There is likely to be an impact on the exchange rates used to account for foreign currency transactions and translation of financial statements. Companies that hold Russian or Ukrainian denominated debt securities classified as available for sale should consider whether changing foreign exchange rates or other factors trigger an impairment.

Entities that have contracts to lease assets such as aircraft, real estate, shipping vessels and telecommunication equipment should monitor events that may indicate that a lease has been terminated or modified and that the lease-related assets may be impaired. Further, entities should monitor any laws or regulations governing their contracts to determine whether there are impacts.

Companies are required to make disclosures about certain risks and uncertainties, including qualitative disclosures about risks and uncertainties that in the near term could significantly affect the amounts reported in the financial statements or the functioning of the reporting entity. Companies whose operations are affected by the current environment may be required to disclose certain significant estimates and current vulnerability due to concentrations (e.g., concentration in the volume of business with a particular customer or supplier or in a market or geographic area). Potential supply chain disruptions may also warrant disclosure.

Domestic and foreign companies that file with the Securities and Exchange Commission (SEC or Commission) should also make sure they have both robust internal controls over financial reporting and robust disclosure controls and procedures so they can timely identify accounting implications and disclose material information related to the war, the sanctions or the ripple effects.

FASB proposes disclosure requirements for supplier finance programs

The Financial Accounting Standards Board (FASB) proposed guidance that would require entities that use supplier finance programs to pay for goods and services to disclose the key terms of the programs and information about their obligations that are outstanding at the end of the reporting period.

The proposal would require the entities to disclose (1) the key terms of the programs as identified by management; (2) the amount of the obligations outstanding at the end of the reporting period that the entity has confirmed as valid to the finance provider or intermediary, where those obligations are presented in the balance sheet and the amounts presented in each line item in the balance sheet if they are presented in more than one; and (3) a rollforward of the obligations presenting, at a minimum, the amount outstanding at the beginning of the reporting period, the amount added to the program during the reporting period, the amount settled during the reporting period and the amount outstanding at the end of the reporting period.
If an entity has more than one program, it would be able to aggregate disclosures but not to the extent that useful information is obfuscated.

The proposed guidance would not require entities to provide disclosures at interim periods and would not affect the recognition, measurement or financial statement presentation of supplier finance program obligations. The guidance would be applied retrospectively, and early application would be permitted.

The SEC staff has said companies should consider making certain disclosures in the management discussion and analysis (MD&A) if the effects of a supplier finance program are material to current period liquidity or are reasonably likely to materially affect liquidity in the future.

### Estimating the annual effective tax rate and reporting income taxes in an interim period

Companies need to keep in mind that, at the end of each interim period, they must make their best estimate of the annual effective tax rate for the full fiscal year and apply that rate to year-to-date ordinary income. As a reminder, the calculation of the annual effective estimated tax rate can be affected by:

- Operations in multiple jurisdictions
- Expectations about whether current-year losses are realizable
- The tax benefit of an operating loss carryforward from a prior year that is realized because of current-year ordinary income
- Tax law changes enacted in the period that affect taxes payable or refundable for the current year

Management also should make sure that forecasts used for estimating income taxes are consistent with those used for other purposes and incorporate the effects of current economic conditions, such as inflation, supply chain slowdowns and rising interest rates.

Companies should monitor tax law changes in the US and other jurisdictions. The effects of a change in tax laws or rates on deferred tax balances are recognized as a discrete event as of the enactment date and should not be allocated to subsequent interim periods by adjusting the estimated annual effective tax rate.

Similarly, the effects of a change in tax laws or rates on taxes payable or refundable for a prior year should be recognized discretely as of the enactment date.

### Effects of rising interest rates and inflation on financial reporting

Companies need to consider the effects of rising interest rates and inflation on their accounting and financial reporting. This includes determining whether MD&A and risk factor disclosures include the most current information, how inflation and supply-chain issues may be affecting cash flow projections used in prospective financial information and what discount rate is used to discount those cash flows.

Rising interest rates also affect lease accounting since they generally increase a lessee’s incremental borrowing rate (IBR), which is used to measure the lease liability for new leases, certain lease modifications and events requiring remeasurement. An increase in a lessee’s IBR would generally result in the recognition of a lower lease liability, if all other variables are constant (e.g., lease payments). Since this rate is entity-specific and considers certain variables included in a lease (e.g., lease term), each lease and each lessee may be impacted by rising interest rates differently.

Given the upward trend in inflation rates globally, entities with foreign operations should monitor inflation rates in foreign countries with high rates in which they operate. If a foreign entity’s local economy becomes highly inflationary, that entity may need to change its functional currency as of the beginning of the reporting period following the period in which the economy becomes highly inflationary.

An economy is considered highly inflationary if it has a cumulative inflation rate of 100% or more over a three-year period. At the end of February 2022, Turkey’s three-year cumulative inflation rate exceeded 100%. Calendar year-end public business entities should continue to monitor Turkey’s three-year cumulative inflation rate to determine whether a change in the functional currency is required on 1 April 2022.
Regulatory developments

SEC proposes requiring more cybersecurity disclosures
The SEC proposed new rules to enhance and standardize disclosures that registrants make about cybersecurity incidents and their cybersecurity risk management, strategy and governance.

Under the proposed rules, registrants would be required to disclose information about a material cybersecurity incident on Form 8-K within four business days of determining that the incident is material.

Registrants would also have to provide updated disclosures in periodic reports about previously reported incidents, describe their policies and procedures, if any, for the identification and management of risks from cybersecurity threats, and provide disclosures about the board's oversight of cybersecurity risk and management's role in assessing and managing this risk and in implementing cybersecurity policies.

In addition, registrants would have to disclose whether they have cybersecurity expert(s) on the board of directors and, if so, provide their name(s) and a description of their experience.

The proposal would apply to nearly all registrants that are required to file periodic reports (e.g., Form 10-K, Form 20-F) with the SEC, including smaller reporting companies and foreign private issuers.

Separately, the SEC proposed new rules and amendments to enhance cybersecurity preparedness and improve the resilience of registered investment advisers, registered investment companies and business development companies against cybersecurity threats and attacks.

SEC staff statement on materiality evaluations of error corrections
SEC Acting Chief Accountant Paul Munter issued a statement saying that the staff continues to focus on registrants' evaluation of whether an error in previously issued financial statements is material and how the error should be corrected.

In the statement, Mr. Munter highlights the importance of registrants, auditors and audit committees applying a well-reasoned, holistic, objective approach that includes consideration of both qualitative and quantitative factors when they assess whether an error is material.

He noted that the SEC staff has challenged registrants' overreliance on qualitative factors to conclude that a quantitatively significant error is immaterial. He also highlighted aspects of materiality analyses to which the SEC staff has taken exception, including arguments that certain GAAP financial statements or line items are irrelevant to investors or that a similar error was made by multiple registrants.

Mr. Munter also noted that the evaluation of the severity of a control deficiency should not be limited to the actual error and must consider the magnitude of the potential misstatement that could result from a control deficiency.

SEC reopens comment period on its ‘pay versus performance’ proposal
The SEC reopened the comment period on its 2015 proposal that would require companies to disclose the relationship between executive compensation actually paid and total shareholder return for up to five years in proxy or information statements in which executive compensation disclosures are required.

The SEC also is now considering whether to require registrants to disclose additional performance measures, including pre-tax net income, net income and a measure selected by the company, as well as a list of a company's five most important performance measures, in order of importance.

The SEC sought comments on the updated proposed rules, which were mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act.
SEC proposes amendments to modernize beneficial ownership reporting
The SEC proposed amendments to Regulation 13D-G that would accelerate the filing deadlines for beneficial ownership reports from 10 days to five days and require amendments to be filed within one business day.

In addition, the proposal would expand the application of Regulation 13D-G to certain derivative securities, clarify the circumstance under which two or more persons have formed a “group” subject to beneficial ownership reporting and require beneficial ownership reports be filed using a structured, machine-readable data language (e.g., Inline XBRL).

SEC proposes changes to whistleblower program rules
The SEC proposed two amendments to the rules governing its whistleblower program to further incentivize individuals to provide original information that leads to successful SEC enforcement actions.

One proposed amendment would allow the SEC to reward a whistleblower for an action that may otherwise be covered by another, non-SEC whistleblower program. The other would affirm the SEC’s authority to consider the dollar amount of a potential award for the limited purpose of increasing it but not lowering it.

SEC issues proposals aimed at enhancing private fund investor protection
The SEC proposed rules and rule amendments under the Investment Advisers Act of 1940 aimed at enhancing investor protection by requiring private funds to be more transparent about the cost of investing and fund performance and prohibiting certain activities.

Under the proposal, SEC-registered private fund advisers would have to provide investors with quarterly statements detailing information about private fund performance, fees and expenses. Among other things, these advisers would have to obtain for each private fund an annual audit and an audit upon liquidation as well as cause the fund’s auditor to confidentially notify the SEC when they issue a modified opinion or terminate the engagement.

Among other things, both registered and non-registered private fund advisers would be prohibited from engaging in certain activities and practices that the SEC believes are contrary to the public interest, such as reducing the amount of an adviser clawback by the amount of certain taxes, and from providing preferential terms to certain investors that have a material negative effect on other investors.

Separately, the SEC proposed requiring certain registered investment advisers to private funds to confidentially report to the SEC within one business day of the occurrence of certain events indicating significant stress at a fund that could harm investors or events signaling risk in the broader financial system.

For large hedge fund advisers, reportable events include extraordinary investment losses, significant margin and default events, and large withdrawals and redemptions. For private equity fund advisers, reportable events include the execution of an adviser-led secondary transaction, implementation of general or limited partner clawbacks, and the removal of a fund’s general partner.

The proposed amendments would also provide the SEC and the Financial Stability Oversight Council with more timely information to analyze and assess risks to investors and the markets more broadly by requiring large private equity advisers to provide more details on the private equity funds they manage than they currently do.

SEC proposes amending certain money market fund rules
The SEC proposed amendments to certain rules that govern money market funds (MMFs) under the Investment Company Act of 1940.

Among other things, the proposal would increase minimum daily and weekly liquid asset requirements, remove the ability of MMFs to impose liquidity fees and redemption gates when liquid assets fall below certain thresholds, require institutional prime and institutional tax-exempt MMFs to implement swing pricing when such funds have net redemptions, and enhance certain reporting requirements to improve the SEC’s ability to monitor and analyze MMF data.

The SEC also stated that the adoption of swing pricing would not preclude shareholders from classifying their investments in MMFs as cash equivalents under normal circumstances.
Regulatory developments

SEC proposes conditions for using trading arrangements as a defense against insider trading

The SEC proposed adding conditions that would have to be met to assert the affirmative defense against insider trading liability in Exchange Act Rule 10b5-1, which allows trades based on a written plan known as a trading agreement that was adopted when the insider was not aware of material nonpublic information, among other things.

The proposal would impose cooling-off periods before trading could commence under a trading plan, prohibit multiple overlapping trading arrangements and limit the use of the affirmative defense for a trading arrangement designed to cover a single trade to one single-trade plan in any 12-month period. The proposal would also require directors and officers to furnish written certifications that they are not aware of any material nonpublic information when they enter into trading plans.

In addition, the proposal would require new disclosures about an issuer’s policies and procedures related to insider trading, including tabular reporting of options granted within 14 days of the release of material nonpublic information and the market price of the underlying securities on the trading days before and after the release of such information.

SEC proposes new disclosures about share repurchases conditions

The SEC proposed requiring issuers to provide disclosures about repurchases of their equity securities before the end of the first business day after a share repurchase. Issuers would be required to disclose on proposed Form SR the total number and class of securities purchased, the average price paid per share and the total number of shares purchased in accordance with a plan intended to satisfy the affirmative defense conditions of Exchange Act Rule 10b5-1(c).

An issuer would be required to disclose the objective or rationale for its share repurchases and its process or criteria used to determine the amount of repurchases as well as any policies and procedures relating to purchases and sales of the issuer’s securities by its officers and directors during a repurchase program (including any restrictions). It also would be required to disclose whether repurchases were made in accordance with a plan intended to satisfy the affirmative defense conditions of Exchange Act Rule 10b5-1(c) and whether repurchases were made in reliance on the nonexclusive safe harbor of Exchange Act Rule 10b-18.

SEC Commissioner Roisman steps down, Lee plans not to seek a second term

Elad L. Roisman resigned as an SEC commissioner. Mr. Roisman had served on the Commission since September 2018 and was acting chairman from December 2020 to January 2021. His departure will leave Hester M. Peirce as the only Republican on the Commission until a new commissioner is nominated by President Biden and confirmed by the Senate.

Separately, Allison Herren Lee said she intends not to seek a second term as Commissioner and will step down once her successor has been confirmed. Ms. Lee has been a Commissioner since 2019 and served as acting chair of the agency from January to April 2021.

PCAOB to form advisory groups to enhance stakeholder engagement

The Public Company Accounting Oversight Board (PCAOB) said it will form two new advisory groups, the Investor Advisory Group and the Standards and Emerging Issues Advisory Group, to help it obtain input and insights from investors and other stakeholders on how to improve audit quality.

The PCAOB issued a request for public comment on the proposed structures of the groups and sought nominations for membership in each group. PCAOB Chair Erica Y. Williams said that the PCAOB intends to move forward quickly to form the advisory groups and hold public meetings as early as this spring.
## Summary of open comment periods

Items are FASB and SEC proposals as noted.

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<td>Proposed Accounting Standards Update — Liabilities — Supplier Finance Programs (Subtopic 405-50): Disclosure of Supplier Finance Program Obligations (FASB proposal)</td>
<td>21 March 2022</td>
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<tr>
<td>Cybersecurity risk governance (SEC proposal)</td>
<td>The later of 30 days after publication of the proposal in the Federal Register or 9 May 2022</td>
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<td>Modernization of beneficial ownership reporting (SEC proposal)</td>
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<td>The Commission's whistleblower program rules (SEC proposal)</td>
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<td>Cybersecurity risk management for investment advisers, registered investment companies, and business development companies (SEC proposal)</td>
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<tr>
<td>Fee transparency from private equity firms and funds (SEC proposal)</td>
<td>The later of 30 days after publication of the proposal in the Federal Register or 11 April 2022</td>
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<td>Amendments to enhance private fund reporting (SEC proposal)</td>
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<td>Money market fund reforms (SEC proposal)</td>
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<td>Rule 10b5-1 and insider trading (SEC proposal)</td>
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- FASB proposes requiring disclosures about supplier finance program obligations (22 December 2021)

Technical Line

- A closer look at accounting for financial instruments issued by SPACs (3 March 2022)
- Navigating the requirements for merging with a special purpose acquisition company (updated 3 March 2022)
- Accounting considerations for lessees that plan to reduce physical workspace (25 February 2022)
- A closer look at the new guidance on accounting for revenue contracts acquired in a business combination (20 January 2022)
- Accounting considerations for transactions and arrangements related to climate change initiatives (6 January 2022)
- New SEC rule on disclosures by bank and savings and loan registrants (22 December 2021)
- How the new leases standard affects real estate entities (21 December 2021)

Financial reporting developments

- Statement of cash flows (updated 11 January 2022)

Comment letters

- FASB proposal on changes to interim reporting disclosure requirements (28 January 2022)
- FASB proposal on TDRs for creditors and vintage disclosures (22 December 2021)

Other

- The Private Angle – Navigating the accounting requirements of the new leases standard (4 February 2022)
- Effective date matrix as of 31 January 2022 (3 February 2022)
- NAIC Bulletin – Fall 2021 edition (27 January 2022)
- SEC in Focus – January 2022 (13 January 2022)
- Accounting pronouncements effective in 2021 (13 January 2022)
- Quarterly Tax Developments – December 2021 (12 January 2022)
- The Private Angle – Starting the journey to implement the new leases standard (6 January 2022)
- US GAAP versus IFRS: The basics – December 2021 (21 December 2021)

On-demand webcasts

- Accounting for income taxes: a quarterly perspective
- Domestic tax quarterly webcast series: a focus on state tax matters
- Financial forecasting to manage through disruption
- Tax aspects of the LIBOR transition: What to consider for year-end
- What you need to know for Q4 2021 financial reporting
- What you need to know now: crypto and digital assets in financial services

Upcoming webcasts

- How audit committees can prepare for the implications of climate risk (29 March 2022)
- PE Portfolio and Private Company Webcast Series: ESG as a value creator (24 March 2022)
- How ESG reporting is accelerating corporate sustainability efforts (22 March 2022)
- Tax in the time of COVID-19: update on legislative, economic, regulatory and IRS developments (18 March 2022)
- What you need to know for Q1 2022 financial reporting (16 March 2022)