Financial reporting briefs

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

September 2023

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Top story

Welcome to the September 2023 Financial reporting briefs. *This edition highlights the latest developments in financial reporting and alerts you to some important considerations for 2023.*

Interested in learning more about the SEC's new cybersecurity disclosure rules? We've got it covered in our Top story.

In our Accounting update *section, we discuss the FASB's new guidance on joint venture formations and proposed guidance on disaggregation of certain income statement expenses.*

In our Regulatory developments *section, we provide updates on SEC, PCAOB and other developments.*

Need more information? *Check out our* Reference library, *where we list our recent publications on the topics discussed here and provide links to them.*

SEC adopts new cybersecurity disclosure rules

The Securities and Exchange Commission (SEC) adopted final rules requiring registrants to disclose information about material cybersecurity incidents on Form 8-K within four business days of determining that an incident is material, with a delay only when the US Attorney General concludes that disclosure would pose a substantial risk to national security or public safety. The rules also require cybersecurity risk management, strategy and governance disclosures on annual reports (e.g., Form 10-K, Form 20-F).

The SEC said the rules are intended to make sure that registrants disclose material cybersecurity information and provide investors with more consistent, comparable and decision-useful information. The rules apply to nearly all registrants that are required to file periodic reports with the SEC, including smaller reporting companies (SRCs) and foreign private issuers (FPIs), except for Canadian FPIs under the multijurisdictional disclosure system.

The rules codify many of the concepts in the interpretive guidance on cybersecurity that the SEC issued in 2018 and in the Division of Corporation Finance's staff guidance on cybersecurity disclosures issued in 2011. However, the rules require more prescriptive disclosures about cybersecurity incidents and risk governance.

Registrants are required to disclose a material incident on Form 8-K and describe the material aspects of the nature, scope and timing of the incident and the material impact or reasonably likely material impact on the registrant's financial condition and results of operations. The rule requires the incident disclosures to primarily focus on the material impacts of the incident, rather than details about the incident itself.

If any required information is not determined or is unavailable at the time the registrant prepares the initial Form 8-K, the registrant must file an amended Form 8-K containing such information within four business days after it determines such information or after the information becomes available.

The rule states that what constitutes materiality for purposes of determining whether an incident must be reported on Form 8-K is consistent with the Supreme Court's definition of materiality, and registrants need to thoroughly and objectively evaluate the total mix of information, taking into consideration all relevant facts and circumstances of the cybersecurity incident, including quantitative and qualitative factors.

The definition of "cybersecurity incident" is expanded to include "a series of related unauthorized occurrences," reflecting the fact that cyber attacks sometimes occur over time. The rule says that the Form 8-K requirement could be triggered even if the material impact to the registrant is caused by a series of individually immaterial related cyber attacks.

Companies may find the requirement to report "a series of related unauthorized occurrences" challenging because the rule does not define "related." For example, registrants may need to develop a process to track individually immaterial related incidents over an undefined time period and identify controls over that process to make sure they are reporting all cybersecurity incidents subject to the rule.

The rules also require registrants to describe in their annual reports the processes they use, if any, to assess, identify and manage cybersecurity risks, the board's oversight of such risks and management's role in assessing and managing such material risks (e.g., whether certain management positions or committees are responsible for assessing and managing cybersecurity risk and their relevant expertise), among other items.

Calendar-year registrants must provide the risk management, strategy and governance disclosures in their 2023 annual reports. All registrants other than SRCs must comply with the incident disclosure requirements beginning on 18 December 2023. SRCs must begin complying with Form 8-K disclosure requirements on 15 June 2024.

Accounting update

FASB issues guidance on joint venture accounting upon formation

The Financial Accounting Standards Board (FASB or Board) issued final guidance requiring certain joint ventures to apply a new basis of accounting upon formation by recognizing and initially measuring most of their assets and liabilities at fair value.

The guidance applies to the formation of joint ventures that meet the definition in Accounting Standards Codification (ASC) 323, *Investments — Equity Method and Joint Ventures*, except those that may be proportionately consolidated by one or more investors in accordance with ASC 810-10-45-14 and those that are not-for-profit entities or collaborative arrangements in the scope of ASC 808, *Collaborative Arrangements*, not conducted in a separate legal entity. The Accounting Standards Update (ASU) does not amend the definition of a joint venture or change the accounting by the investors in a joint venture.

The guidance is effective for all joint venture formations with a formation date on or after 1 January 2025. Early adoption is permitted. Joint ventures formed before the effective date have the option to apply it retrospectively if they have sufficient information, while those formed after the effective date are required to apply it prospectively.

FASB proposes disaggregation of certain income statement expenses

The FASB proposed requiring a public business entity (PBE) to disclose, on an annual and interim basis, disaggregated information about certain income statement expense line items. The proposal addresses investors' requests for more detailed expense information, which they said is critical to understanding an entity's performance, assessing its prospects for future cash flows, and comparing its performance both over time and with that of other entities. The proposal would not change what a PBE presents on the face of its income statement.

PBEs would be required to disclose inventory and manufacturing expenses, employee compensation, depreciation, intangible asset amortization and, for oil- and gas-producing activities, depreciation, depletion and amortization (DD&A) for each line item that contains those expenses. For inventory and manufacturing expenses, a PBE would also have to further disclose costs incurred for inventory purchases, employee compensation, depreciation, intangible asset amortization and DD&A.

Specified expenses, gains or losses that are already disclosed under existing US GAAP would also have to be included in the disaggregated line item disclosures, and any remaining amounts would have to be described qualitatively. PBEs would also be required to separately disclose total selling expenses and an entity's definition of those expenses.

PBEs would be required to apply the guidance prospectively but would be permitted to apply it retrospectively. The FASB said it would determine an effective date and whether early adoption would be permitted after it receives feedback on the proposal. The FASB is scheduled to host a public roundtable on 13 December 2023.

FASB proposes expanding gross-up approach in ASC 326

The FASB proposed requiring entities to apply the gross-up approach in ASC 326, *Financial Instruments — Credit Losses*, to all financial assets acquired in a business combination and to those acquired in an asset acquisition or recognized through the consolidation of a variable interest entity (VIE) that is not a business, if they meet certain seasoning criteria, with limited exceptions. The gross-up approach is currently applied only to purchased financial assets with credit deterioration (PCD).

To be considered seasoned, financial assets would have to be acquired in an asset acquisition or recognized through the consolidation of a VIE that is not a business (with limited exceptions) more than 90 days after the origination date and if the entity was not involved with the origination. In addition, the Board concluded that financial assets acquired in a business combination would be presumed seasoned, and therefore, the gross-up approach would also apply to them.

The proposal is aimed at addressing stakeholder concerns raised during the FASB's post-implementation review of the credit losses standard about the complexity of applying the current guidance and the lack of comparability in the accounting for PCD and non-PCD assets.

The proposal would apply to all financial assets, including credit cards and other revolving credit arrangements, trade accounts receivables, contract assets and sales-type and direct financing lease receivables. It would not apply to available-for-sale (AFS) debt securities.

The proposal would not change measurement, presentation or disclosure requirements for acquired financial assets that are accounted for using the gross-up approach.

The proposal would be applied on a modified retrospective basis to all prior periods presented in financial statements for which an entity has adopted ASU 2016-13.

FASB moves forward with guidance on additional income tax disclosures

The FASB recently discussed stakeholder feedback on its March 2023 proposal to require entities to provide more information in the rate reconciliation table and about income taxes paid. At its 30 August 2023 meeting, the Board reaffirmed many of its previous decisions and made additional decisions related to the presentation of reconciling items, the disclosure of changes in unrecognized tax benefits, the effective date and transition, and other matters. The FASB also directed the staff to draft a final ASU, which is expected to be issued in the fourth quarter of 2023.

Regulatory developments

PCAOB proposes expanding auditor's responsibilities

The Public Company Accounting Oversight Board (PCAOB) proposed expanding the auditor's responsibility for considering a company's noncompliance with all laws and regulations, including those related to fraud, and eliminating the distinction between direct and indirect effects on financial statements in today's standard.

The proposal would expand the evidence auditors need to obtain to understand the registrant's processes and identify laws and regulations that could reasonably have a material effect on the financial statements if the registrant didn't comply with them. Auditors would then be required to plan and perform specified procedures to determine whether there is information indicating that noncompliance has or may have occurred.

The proposal would significantly increase the level of effort auditors expend to understand laws and regulations that may have an indirect effect on the financial statements and to assess the risks that noncompliance could reasonably result in a material misstatement to the financial statements.

Because of the complexities associated with understanding and assessing what conduct and activities would represent noncompliance, as well as their potential effect on the financial statements, auditors would likely need to rely heavily on lawyers and other specialists to comply with the proposed requirements.

The auditor would also be required to communicate to management and the audit committee when the auditor becomes aware of information indicating that noncompliance with laws and regulations, including those related to fraud, has or may have occurred. After the auditor completes the evaluation, the auditor communicates to management and, unless the matter is clearly inconsequential, to the audit committee the results of the evaluation, including whether it is likely that noncompliance has occurred and, for instances of likely noncompliance, whether there is a material effect on the financial statements. If the information is subsequently determined to be "clearly inconsequential," the auditor would only have to communicate the conclusion of the matter to management.

In addition, auditors would be required to make additional communications directly to the board of directors in certain circumstances (e.g., when they conclude that the likely noncompliance has a material effect on the financial statements).

Questions for audit committees to consider regarding the auditor's work

The PCAOB issued a staff publication, *Spotlight: Audit Committee Resource*, that includes questions audit committee members may want to consider among themselves or in discussions with their independent auditors in light of the current economic and geopolitical landscape. The questions address the auditor's work on risk of fraud, risk assessment and internal controls, auditing and accounting risks, digital assets, mergers and acquisitions, and other areas.

California governor to sign climate disclosure bills

Gov. Gavin Newsom of California said he will sign two bills into law requiring entities that do business in California and meet certain annual revenue thresholds to provide climate-related disclosures, including Scope 1, 2 and 3 greenhouse gas emissions, and disclosures in accordance with the recommendations of the Task Force on Climate-related Financial Disclosures. Both bills would require initial disclosures in 2026. The disclosures would be similar to those that the SEC proposed requiring in March 2022, but the California requirements would apply to both public and private entities. California would be the first state to broadly require climate-related disclosures.

Entities with more than $1 billion in annual revenue would be required to annually disclose their Scope 1, 2 and 3 emissions and obtain assurance over those disclosures. Companies with more than $500 million in revenue would have to biennially provide disclosures (1) in accordance with the recommendations of the Task Force on Climate-related Financial Disclosures, which include disclosure of Scope 1 and 2 emissions, and (2) on the measures they adopted to reduce and adapt to identified climate-related risks.

Trends in 2023 SEC staff comment letters

Management's discussion and analysis (MD&A) and non-GAAP financial measures remained in the top two spots of our list of the most frequent topics in SEC staff comment letters for the year ended 30 June 2023. The volume of comment letters issued on periodic reports jumped close to 60% from the previous year, mostly fueled by the SEC staff's continued focus on MD&A and non-GAAP measures. Segment reporting and revenue recognition continue to be the two most frequent accounting topics resulting in staff comments.

Climate-related disclosures also continued to be one of the most frequent comment areas, with the number of registrants receiving a letter on this topic increasing by about 25% from the previous year. We expect the SEC staff to continue focusing on these disclosures in its reviews of year-end reporting, even as the SEC works to finalize new rules to require more extensive disclosures in the future. On average, staff comments on climate-related disclosures continued to require more rounds of comments to resolve than those on the other topics on our list.

We expect that the SEC staff will continue commenting on the above topics and may expand its comments related to pay versus performance, cybersecurity and other disclosures related to recently issued or amended SEC rules and financial accounting standards.

SEC staff issues guidance on insider trading plans and related disclosures

The SEC staff published compliance and disclosure interpretations (C&DIs) on the amended rules on insider trading plans under Rule 10b5-1 and related disclosures. The C&DIs clarify the scope of trading arrangements subject to certain disclosure rules, the requirements to disclose trading plan terminations, the trading cooling-off period imposed by the amendments and the availability of the Rule 10b5-1 affirmative defense to certain 401(k) plan participants, among other matters.

The SEC previously adopted amendments to Rule 10b5-1 under the Securities Exchange Act of 1934 and new disclosure requirements aimed at enhancing investor protections against insider trading and help shareholders understand when and how insiders are trading in securities when they may have material nonpublic information.

SEC requires private fund advisers to disclose more to investors, restricts certain activities

The SEC adopted new rules under the Investment Advisers Act of 1940 that require SEC-registered private fund advisers to:

- Provide investors with quarterly statements with detailed information about private fund performance, fees and expenses
- Obtain an annual audit for each advised private fund and distribute audited financial statements to current investors within 120 days of each fund's fiscal year end
- Obtain a fairness or valuation opinion in connection with an adviser-led secondary transaction

The rules restrict certain activities and prohibit all private fund advisers from providing certain treatment deemed preferential, as well as other types of preferential treatment, unless it is disclosed to current and prospective investors and/or investor consent is received. The rules also require all registered advisers, including those that do not advise private funds, to document the annual review of their compliance policies and procedures in writing beginning 13 November 2023.

The rules do not apply to advised securitized asset funds, and the audit requirement does not apply to a special purpose vehicle unless the adviser treats it as a separate client.

Compliance with the quarterly statement and audit rules is required beginning 14 March 2025. Compliance with the other rules is required beginning 14 September 2024 for advisers with $1.5 billion or more in private funds assets under management and beginning 14 March 2025 for advisers with less than $1.5 billion in private funds assets.

SEC amends money market fund rules, Form PF reporting requirements for large liquidity fund advisers

The SEC amended certain rules that govern money market funds under the Investment Company Act of 1940. The amended rules increase the daily and weekly minimum liquidity requirements to 25% and 50% of a fund's total assets, respectively, and remove provisions that permitted a money market fund to temporarily suspend redemptions and tied the imposition of liquidity fees to a fund's liquidity level.

The amendments require institutional prime and institutional tax-exempt money market funds to impose liquidity fees when they experience daily net redemptions that exceed 5% of net assets, unless the fund's liquidity costs are *de minimis*. They also allow retail and government money market funds to handle a negative interest rate environment by either converting to a floating share price or reducing the number of shares outstanding to maintain a stable net asset value per share. The amendments also require additional information about large private liquidity funds on Form PF.

The amendments are effective 2 October 2023, with a tiered transition period for compliance. The reporting form amendments are effective 11 June 2024.

SEC proposes rules for use of predictive data analytics by broker-dealers and investment advisers

The SEC proposed new rules and amendments to address conflicts of interest in the use of predictive data analytics by broker-dealers and investment advisers (collectively, firms) in investor interactions.

The proposal would primarily require firms to eliminate or neutralize conflicts of interest associated with their use of covered technologies in investor interactions. Firms that have any investor interaction using covered technology would be required to have written policies and procedures reasonably designed to prevent violations of (in the case of investment advisers) or achieve compliance with (in the case of broker-dealers) the proposed rules.

SEC proposes internet adviser registration reforms

The SEC proposed amending the internet adviser exemption from the prohibition on SEC registration for smaller investment advisers by requiring an investment adviser relying on the exemption to have at all times an operational interactive website through which the adviser provides investment advisory services on an ongoing basis to more than one client.

The proposed amendments would also eliminate the current rule's *de minimis* exception for non-internet clients, thus requiring that the adviser give advice to all its clients exclusively through an operational interactive website.

Banking agencies propose new capital requirements for Basel III endgame

US banking regulators proposed new capital requirements for banks with $100 billion or more in total assets and for smaller banks with significant trading activity, defined as $5 billion or more in trading assets plus trading liabilities or 10% or more of total assets.

The proposed rules, issued jointly by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation, would replace the regulators' risk-based capital framework for large banks with a new framework, commonly referred to as the Basel III endgame reforms.

Under the proposal, all banks with assets greater than $100 billion would be required to calculate their capital ratios twice, first under a new expanded risk-based approach and then under the current standardized approach. The capital ratios would then be evaluated using the lower (stricter) of the two approaches. The proposal would generally eliminate the ability to use advanced internal rating-based models and also require large banks to include unrealized gains and losses from AFS securities in their capital ratios.

If the rules are adopted, banks will have two years to implement the new requirements with an effective date of 1 July 2025. The capital impacts will phase in over a three-year period.

Other considerations

EC adopts sustainability reporting standards

The European Commission (EC) adopted its first set of European Sustainability Reporting Standards (ESRS) for use by all companies subject to the Corporate Sustainability Reporting Directive (CSRD) of the European Union (EU). The ESRS require entities to make sustainability disclosures, including certain climate disclosures.

The ESRS require an entity to disclose in its management report how material sustainability-related risks and opportunities have affected its current financial performance, financial position and cash flows. An entity is also required to disclose how it anticipates its financial performance, financial position and cash flows will change over the short, medium and long terms under the effects of material sustainability-related risks and opportunities.

Ten topical standards include sector-agnostic disclosure requirements for environmental, social and governance (ESG) matters aimed at helping users of an entity's sustainability report understand the entity's impact on these ESG matters, the entity's material risks and opportunities related to these matters, and the impact of these matters on the entity's ability to create value. The topical standards include disclosure requirements that cover policies, targets, action plans and resources, as well as performance measurements in relation to the ESG matters.

Compliance with the final standards will be mandatory after the CSRD is included in the local law of each EU Member State, which is required by July 2024.

While the CSRD is binding on EU member states, the states have some authority to choose the form and methods to achieve the required result as they incorporate the directive into local law. Companies should monitor the local laws of relevant EU jurisdictions.

Summary of open comment periods

Proposal	Comment period ends
Exemption for Certain Investment Advisers Operating Through the Internet (SEC proposal)	2 October 2023
Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker Dealers and Investment Advisers (SEC proposal)	10 October 2023
Safeguarding Advisory Client Assets (SEC proposal)	60 days after publication of the reopening release in the Federal Register
Proposed Accounting Standards Update — Income Statement — Reporting Comprehensive Income — Expense Disaggregation Disclosures (Subtopic 220-40): Disaggregation of Income Statement Expenses (FASB proposal)	30 October 2023
Regulatory capital rule (Basel III endgame): Amendments applicable to large banking organizations and to banking organizations with significant trading activity (Banking regulatory agencies proposal)	30 November 2023

Reference library

Click on any of the EY publications below, all of which are available free of charge on AccountingLink at www.ey.com/en_us/assurance/accountinglink.

To the Point

- California enacts two climate disclosure laws (20 September 2023)
- FASB moves forward with guidance to enhance income tax disclosures (14 September 2023)
- SEC requires private fund advisers to disclose more to investors and restricts certain activities (7 September 2023)
- FASB requires joint ventures to measure most assets and liabilities at fair value upon formation (30 August 2023)
- FASB proposes requiring public business entities to disaggregate certain income statement expenses (2 August 2023)
- SEC adopts disclosure requirements for cybersecurity incidents and risk management and governance (27 July 2023)
- FASB proposes expanding the gross-up approach in ASC 326 to almost all acquired financial assets (29 June 2023)
- PCAOB proposes expanding auditor's responsibilities for considering noncompliance with all laws and regulations (29 June 2023)

Technical Line

- How the climate-related disclosures from the SEC proposal, the EFRAG and the ISSB standards compare (20 September 2023)
- How the EU's Corporate Sustainability Reporting Directive affects non-EU based multinationals (20 September 2023)
- A closer look at the SEC's new rules on cybersecurity disclosures (30 August 2023)

Financial reporting developments

- Revenue from contracts with customers (ASC 606) (12 September 2023)
- Issuer's accounting for debt and equity financings (after the adoption of ASU 2020-06, Accounting for Convertible Instruments and Contracts in an Entity's Own Equity) (31 August 2023)
- Issuer's accounting for debt and equity financings (before the adoption of ASU 2020-06, Accounting for Convertible Instruments and Contracts in an Entity's Own Equity) (31 August 2023)
- Lease accounting — Accounting Standards Codification 842, Leases (31 August 2023)
- Exit or disposal cost obligations (23 August 2023)
- Earnings per share (14 August 2023)
- Statement of cash flows (2 August 2023)
- Discontinued operations — Accounting Standards Codification 205-20 (31 July 2023)
- Equity method investments and joint ventures (26 July 2023)
- Accounting for certain life insurance and annuity products (19 July 2023)
- Business combinations (29 June 2023)
- Consolidation: Determination of a controlling financial interest and accounting for changes in ownership interests (26 June 2023)
- Income taxes (26 June 2023)
- Intangibles — Goodwill and other (22 June 2023)
- Transfers and servicing of financial assets (22 June 2023)
- Foreign currency matters (22 June 2023)

Comment letters

- FASB proposal on purchased financial assets (28 August 2023)
- PCAOB proposal on Technology-Assisted Analysis (TAA) (28 August 2023)
- PCAOB proposal expanding auditor's responsibilities for considering noncompliance with all laws and regulations (7 August 2023)
- FASB proposal on the application of the scoping guidance in ASC 718 to profits interest awards (10 July 2023)
- National Telecommunications and Information Administration AI Accountability Policy (12 June 2023)

Other

- EITF Update (21 September 2023)
- SEC Reporting Update — Highlights of trends in 2023 SEC staff comment letters (14 September 2023)
- Guide to preparing carve-out financial statements (26 July 2023)
- SEC in Focus — July 2023 (20 July 2023)
- Effective date matrix as of 30 June 2023 (20 July 2023)
- Quarterly Tax Developments — June 2023 (29 June 2023)

On-demand webcasts

- Accounting for income taxes: a quarterly perspective
- What you need to know for Q2 2023 financial reporting
- What audit committees need to know for Q2 2023
- Navigating the changing global tax landscape
- How to prioritize governance in your organization's ESG strategy
- EY global economic outlook July 2023
- Enhancing ESG reporting: leveraging COSO guidance
- Basel III Endgame: what you need to know
- Domestic tax quarterly webcast series: a focus on state tax matters

Upcoming webcasts

- What you need to know for Q3 2023 financial reporting (Live — offering 1of 2) (21 September 2023)
- What you need to know for Q3 2023 financial reporting (Replay — offering 2 of 2) (26 September 2023)
- Accounting for income taxes: a quarterly perspective (26 September 2023)
- Spotlight on BEPS 2.0 for US MNEs (11 October 2023)
- Audit committee responses to new cybersecurity developments (12 October 2023)

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