A look at this quarter's financial reporting matters

Introduction

In the third quarter of 2021, many companies are keeping a close eye on developments in Washington, including infrastructure legislation and tax reform. The timing for tax reform is not yet clear; however, companies will need to react quickly if new tax laws are enacted. We summarize the key tax reform proposals and how companies can plan ahead. At the SEC, Chair Gary Gensler provided more details on a proposal for mandatory climate risk disclosures, predicting its completion by year's end.

Chair Gensler also went on record with his views on the crypto ecosystem, comparing it to the "wild West" and calling for more investor protection. Whether it's stablecoins or CBDCs, if you're having trouble keeping up on the crypto lingo, you're not alone. Head to Ask the National Office for a primer on crypto assets and some of the related accounting considerations.

Another phrase you may begin hearing more often is energy efficiency-as-a-service. We explore the accounting implications of this growing ESG trend, including the potential for embedded leases.

In standard-setting news, the FASB is still awaiting feedback from stakeholders on its future agenda, including whether it should tackle emerging topics in crypto and ESG. In the meantime, the FASB has added projects to make course corrections on accounting for credit losses and issued new narrow-scope standards you'll want to have on your radar.

This edition of *The quarter close* highlights these and other relevant accounting and reporting topics you should consider as you close out the third quarter of the year.

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Planning ahead for tax reform

Although the specific details and timing of US tax law changes remain uncertain, President Biden and Democratic Congressional leaders have indicated that they are seeking to complete action on the Administration's budget proposals before the end of 2021. Under US GAAP, the effects of a change in tax law or rates are recognized in the period that includes the enactment date. For US federal tax purposes, the enactment date is generally the date the President signs the bill into law. That means companies should start preparing now for the accounting and reporting implications of potential tax law changes.

In May, the Department of the Treasury released details on President Biden's budget proposal, which includes a number of proposed amendments to US tax law that will impact businesses. Some of the significant proposals are:

- an increase in the corporate tax rate from 21% to 28%,
- changes to foreign income inclusions and elimination of deductions for US multinational corporations,
- additional interest expense limitations for consolidated financial reporting groups,
- a minimum tax on book earnings of large corporations, and
- new incentives for onshoring jobs to the US, a number of new and amended credits, changes to the foreign tax credit regime, and disincentives for inverting to a foreign jurisdiction.

These proposals are likely to change during the negotiation process. However, actions companies can take now include modeling the impacts of President Biden's proposals, understanding and gathering the relevant data needed for computations, and identifying resources and technical expertise needed to analyze and account for the tax law changes in the period of enactment.

For further information on President Biden's tax proposals, listen to our *Forecast 2021: Demystifying Biden's new tax proposals* podcast and read our Tax Insights *Treasury 'Green Book' describes Biden's tax proposals for businesses* and *Tax accounting considerations of the Treasury "Green Book."*

Making news in ESG

"When it comes to climate risk disclosures, investors are raising their hands and asking regulators for more."

—SEC Chair Gary Gensler, July 2021

This quarter, SEC Chair Gary Gensler confirmed he is targeting a proposal for mandatory climate risk disclosures by the end of the year. He cited investor demand for information and noted that three out of four responses to the SEC's request for input supported mandatory disclosures. Chair Gensler described various metrics under consideration, including greenhouse gas emissions, financial impacts of climate change, and progress towards climate-related goals.

Chair Gensler also tweeted his intentions for a proposal on human capital disclosures, but he did not provide a specific timeframe. Metrics could include information about turnover, training, compensation, demographics, and health and safety.

For the latest on ESG, watch the replay of our webcast, *ESG: What finance teams need to know*, and visit our ESG "hot topics" page.

Inside scoop

Insights from the frontlines

Here are some of the technical accounting trends we're seeing during the third quarter of 2021:

Buying energy efficiency-as-a-service? You may also be entering into a lease

Many companies are embracing ESG and looking for ways to demonstrate their commitment to energy efficiency. Vendors are marketing service offerings, often referred to as energy efficiency-as-a-service, that promise to reduce or eliminate upfront costs, reduce energy costs, and reduce environmental impact in exchange for payments over time.

In a typical energy efficiency-as-a-service arrangement, a third-party vendor incurs the costs associated with identifying needed capital improvements or asset additions and then ensures construction, procurement, installation, and maintenance to improve efficiency. These capital improvements and asset additions are typically located on the customer's premises. The vendor retains ownership of the assets and charges the customer a service fee that may be determined based—in whole or in part—on actual efficiency performance metrics achieved.

Although marketed as a service, customers must evaluate these arrangements to determine whether they contain embedded leases. Failure to identify and account for embedded leases can have a significant impact on the financial statements.

Identifying embedded leases

Judgment is often required when identifying embedded leases. A contract contains a lease under ASC 842 if (1) it contains an explicitly or implicitly-identified asset that is physically distinct and (2) the customer will control the use of the identified asset.

If the vendor has the practical ability to substitute the identified asset without requiring customer approval, and doing so would be economically beneficial to the vendor, the arrangement would not contain a lease.

The assessment will also require determining whether the customer has the right to control the asset throughout the period of use. Control involves directing how and for what purpose an asset is used while obtaining substantially all of the economic benefits from the use of the asset. Economic benefits include the output from the asset, but may also include other benefits a customer may be entitled to, such as environmental incentives and rebates arising from the use of the assets.

A vendor may use multiple assets to fulfill the energy efficiency services arrangement, which typically requires each functionally-independent asset to be evaluated individually.

Applying the lease guidance

It's unlikely that an entire energy efficiency-as-a-service arrangement will be subject to lease accounting. These arrangements are complex and often involve substantial non-lease goods or services that may need to be accounted for under other US GAAP.

Since the arrangements often require periodic fixed payments from the customer, these payments are allocated to the leased assets and non-lease goods or services based on their relative standalone selling prices. Payments allocated to leased assets would be recognized as a right-of-use asset and lease obligation on the customer's (lessee's) balance sheet.

For more information on identifying embedded leases and their accounting impact, refer to Section 2.3 of our *Leases* guide.

Ask the National Office

Perspectives from our professionals

Getting up to speed on crypto assets

Beth Paul

Deputy Chief Accountant, PwC National Office

Crypto assets, cryptocurrencies, stablecoins, central bank digital currencies (CBDCs)—what do these terms mean?

Beth: Crypto assets are transferable digital representations that are designed in a way that prohibits their copying or duplication. The technology that facilitates the transfer of crypto assets is referred to as blockchain or distributed ledger technology. Crypto assets come in a variety of forms, and new assets continue to be created.

Cryptocurrencies, such as Bitcoin, operate independent from a central bank and are intended to function as a medium of exchange or store of value.

Stablecoins are a type of cryptocurrency that includes mechanisms designed to minimize price volatility by linking their value to a more traditional asset, such as a fiat currency or a commodity.

A CBDC is the digital representation of sovereign currency that is issued by a central bank and represents a claim against the issuing central bank. Many countries are in some stage of researching or developing CBDCs.

If a company holds crypto assets, which accounting guidance applies?

Beth: There is currently no GAAP standard that explicitly addresses the accounting for crypto assets. To determine the appropriate accounting, you have to understand the rights and other features specific to the asset. For example, some crypto assets provide the holder with an interest in another asset and might be accounted for in a manner similar to the underlying asset. There is no one-size-fits-all accounting model for crypto assets.

Many crypto assets do not meet the definition of cash or a financial instrument. And, given crypto assets are not tangible assets, they do not meet all the requirements of inventory. As a result, many crypto assets should be accounted for as indefinite-lived intangible assets.

What is the general accounting for crypto assets that are indefinite-lived intangible assets?

Beth: Crypto assets accounted for as indefinite-lived intangible assets are initially recorded at cost and are not subject to amortization. Subsequently, they are tested for impairment annually and more frequently when a triggering event occurs. A triggering event may occur if there is a transaction in which an identical asset is bought or sold at a price below the current carrying value. These triggering events could occur frequently for crypto assets that trade regularly and have fluctuating prices. If the asset is impaired, it will be written down to fair value. However, increases in fair value are not recognized until the company sells the crypto asset.

What are some other key considerations for companies that hold crypto assets?

Beth: Some companies use a third-party custodian to address security concerns surrounding crypto assets. This can require additional analysis to assess which party controls the assets.

The accounting for crypto assets also often requires robust processes and controls to monitor and evaluate pricing information to identify potential impairments. Crypto assets do not trade on traditional markets with established trading hours, which creates additional challenges for monitoring pricing changes.

There are a lot of things to consider when holding crypto assets--governance, taxes, valuation, controls, to name a few. So, we've only scratched the surface of this topic.

For more on the accounting for crypto assets, read our new *Crypto Assets* guide and listen to our *Forecast 2021: The rise in central bank digital currencies* and *Cryptocurrency? Digital asset? What's the accounting?* podcasts.

In transition

Practical reminders for new standards

Here are updates and insights on recently-issued standards as you prepare to adopt the new guidance:

New guidance on liabilities and equity effective soon

The adoption of ASU 2020-06, the new guidance on liabilities and equity, is coming up soon, as it is effective for calendar year-end public business entities in January 2022. The guidance simplifies the accounting for certain financial instruments by reducing the number of accounting models for convertible debt and convertible preferred stock instruments. In addition, the FASB amended the derivative guidance for the "own stock" scope exception and certain aspects of the guidance for calculating earnings per share (EPS).

ASU 2020-06 could have significant—and unexpected—consequences related to how certain instruments are reflected on a company's balance sheet and treated in EPS. Therefore, it is important to evaluate its implications in advance of the period of adoption. Additionally, companies should continue to reassess their related disclosures of the impact of accounting standards issued but not yet effective (SAB 74 disclosures). These disclosures are generally expected to become more detailed in reporting periods closer to a standard's adoption date.

For further information on the impact of adopting the new standard, refer to our *Financing transactions* guide and read our In depths, *Adopting the new liability and equity guidance early* and *Accounting for convertible instruments and own equity contracts*.

FASB issues the latest amendments to the leases standard

On July 19, the FASB issued ASU 2021-05, which requires a lessor to classify a lease with variable lease payments (that do not depend on an index or rate) as an operating lease if (1) the lease would have been classified as a sales-type or direct financing lease, and (2) the lessor would have recognized a selling loss at lease commencement. These changes are intended to avoid recognizing a day-one loss for a lease with variable payments even though the lessor expects the arrangement will be profitable overall.

The amendments are effective for all entities for fiscal years beginning after December 15, 2021. For public business entities, the ASU is effective for interim periods within those fiscal years. For all other entities, the ASU is effective for interim periods within fiscal years beginning after December 15, 2022.

FASB adds new disclosure requirements for government assistance

The FASB will soon finalize new disclosures for business entities receiving government assistance by issuing ASC 832, *Disclosures by Business Entities about Government Assistance*. The disclosures will be required for transactions with a government that are accounted for by applying a grant or contribution model by analogy, such as IFRS guidance on government grants in IAS 20 or the guidance on contributions for not-for-profit entities in ASC 958-605. This could include various forms of government assistance, but excludes transactions in the scope of specific US GAAP, such as tax incentives accounted for under ASC 740, *Income taxes*. Companies will need to provide information about the nature of the assistance received, including significant terms and conditions, as well as the company's accounting policy and the specific financial statement line items affected. The new guidance is expected to be effective for all entities for annual reporting periods beginning after December 15, 2021.

On the horizon | Standard-setting developments

Here are standard-setting developments you need to know about as we make our way through 2021:

Update on credit losses: FASB moving forward on three projects

The FASB is currently in the midst of its post-implementation review (PIR) of ASU 2016-13, the new guidance on credit losses. The PIR has involved outreach with numerous stakeholders, including public companies who have adopted the credit losses standard, private companies who have not yet adopted the standard, auditors, regulators, investors, and analysts. Although the PIR is ongoing, the FASB has already decided to add (or continue) projects on three topics.

First, the FASB decided to add a project to its technical agenda to address whether to remove the guidance on troubled debt restructurings (TDRs) for creditors who have adopted ASU 2016-13. This project will include considering what disclosures or disclosure enhancements would be necessary if the TDR guidance is eliminated.

The FASB also added a project to consider expanding the scope of the accounting model for purchased credit deteriorated (PCD) assets to all loans acquired in business combinations and modifying elements of the presentation for acquired financial assets that apply the PCD model. The FASB instructed the staff to perform further research on whether (1) the scope of the project should be expanded to other purchased assets (other than loans) and/or all acquired loans (i.e., those acquired in asset acquisitions), and (2) certain assets (e.g., credit cards, available-for-sale debt securities, beneficial interests) should be excluded from the PCD guidance.

Lastly, the FASB voted to keep a project on whether gross writeoff and recovery information should be presented in the required vintage disclosure table.

For more information on credit losses, refer to Chapter 7 of our *Loans and investments* guide.

FASB votes to finalize amendments for revenue contracts acquired in a business combination

On July 28, the FASB decided to finalize amendments to the guidance in ASC 805, *Business combinations*, that will change how contract assets and contract liabilities arising from contracts with customers are measured when acquired in a business combination. Under the revised guidance, an acquirer will recognize and measure contract assets and contract liabilities at the acquisition date in accordance with the provisions of ASC 606, *Revenue from contracts with customers*, rather than at fair value. The new guidance is intended to improve consistency in revenue recognition in the post-acquisition period for acquired contracts as compared to contracts entered into after the business combination.

The FASB expects to issue the final standard in the upcoming months. It is expected to be effective for fiscal years beginning after December 15, 2022 for public business entities. Nonpublic business entities will have an additional year to adopt. Early adoption will be permitted.

Project spotlight

FASB awaits feedback on its future standard-setting agenda

The FASB issued an invitation to comment at the end of June as part of its agenda consultation, a process it last took on in 2016. The request describes four types of potential projects: 1) greater disaggregation of financial information, 2) emerging transactions, 3) reduction of complexity in existing GAAP, and 4) improvements to the FASB's standard-setting processes. Responses to the invitation to comment are due September 22, after which the FASB will use the feedback to help decide where to focus its standard-setting efforts going forward.

PwC's accounting podcasts

PwC's Accounting podcast series includes a library of podcasts covering the most significant accounting and reporting trends relevant for the third quarter close.

Our *Full disclosure* summer podcast series brings you back to the basics on all things related to financial statement presentation and disclosure, from the top of the financial statements through the footnotes. The discussions include a refresher on a number of your favorite topics. Take a listen—you might learn something new!

Some of the most popular podcasts from this quarter:

Forecast 2021: Demystifying Biden's new tax proposals

Forecast 2021: Data storytelling—the skill of rockstar analysts

Full disclosure: Income taxes

Full disclosure: Investments—debt and equity securities

Full disclosure: PPE, inventory, intangibles & goodwill

For all of our podcasts on today's most compelling accounting and financial reporting issues, subscribe to our podcast feed on your podcast platform of choice.

Accounting and reporting webcasts

Register for our Quarterly accounting and reporting webcast to earn CPEs while staying up to date on accounting, reporting, and governance trends every quarter.

Some of our most popular recent webcasts:

Lease accounting - Springing forward (CPE-eligible webcast replay)

Rebuilding revenue - Accounting and reporting trends in revenue (CPE-eligible webcast replay)

ESG: What finance teams need to know

In depth

Domestic SPAC mergers - financial reporting and accounting considerations (updated April 27, 2021)

In brief

Treasury 'Green Book' describes Biden's tax proposals for businesses

Demystifying deferred tax accounting

In the loop

Making sense of ESG

Don't wait until the SEC staff asks you about climate change

The SPAC spree: Current state

Accounting for your company's zero-carbon future

Governance insights

A deeper dive into talent management: the new board imperative

How boards can confront the crisis of prosperity

Disruption, the crisis of technology, and the board

Companies are trust leaders. Here's what that means for corporate boards

The world needs a new type of leader—how can companies and their boards step up?

The audit committee's role in sustainability/ESG oversight

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Appendix Effective dates

Calendar year-end	PBEs	Nonpublic companies
2021	Equity securities, equity method, and derivatives (a) Simplifying accounting for income taxes	Cloud computing Collaborative arrangements Consolidation: VIE related party Defined benefit plan disclosure requirements Episodic television series Goodwill: Evaluating triggering events Hedging
2022	Convertible debt and contracts in own equity (b) Freestanding equity-classified written call options (a) Lessors: Leases with variable lease payments	Equity securities, equity method, and derivatives (a) Freestanding equity-classified written call options (a) Leases (c) NFP entities: contributions of non-financial assets Simplifying accounting for income taxes
2023	Insurance: long-duration contracts (d)	Credit losses (e) Goodwill impairment (e)
2024		Convertible debt and contracts in own equity (b)
2025		Insurance: long-duration contracts (d)

a) A consensus of the FASB Emerging Issues Task Force.

b) Effective in 2022 for SEC filers other than SRCs, and effective in 2024 for all other entities, including SRCs.

c) Includes adoption of amendments to leases standard.

d) Effective in 2023 for SEC filers other than SRCs, and effective in 2025 for all other entities, including SRCs.

e) Effective in 2020 for SEC filers other than SRCs, and effective in 2023 for all other entities, including SRCs.

For further information on newly issued accounting guidance for public and nonpublic companies, including links to the relevant PwC resources, refer to the Guidance effective for calendar year-end public companies and Guidance effective for calendar year-end nonpublic companies pages on Viewpoint.

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