The quarter close

September 20, 2023

A look at this quarter's financial reporting matters

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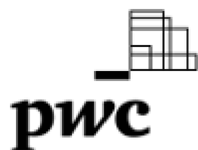
Introduction

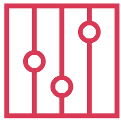
Summer may be known for its "lazy days," but this year, there was a flurry of activity from regulators and standard setters during the third quarter. At press time, the SEC has not yet voted on a final climate rule; however, in July, the SEC issued final requirements for disclosures about cybersecurity. In *Ask the National Office*, we highlight key aspects of the new rule and what companies should be thinking about now.

On the ESG front, it was a historic quarter for sustainability reporting as final standards were adopted in Europe and the new international sustainability standard setter issued its first two disclosure standards. Here in the US, California is poised to pass its own emissions and climate-risk disclosure laws, potentially impacting over 10,000 US public and private companies. We provide the resources you need to determine how these developments could impact your company.

The FASB was also active this quarter, releasing a final standard on joint ventures and two proposals on the disaggregation of income statement expenses and accounting for purchased financial assets. The FASB also finalized decisions on three major projects – segment reporting, income tax disclosures, and crypto assets – with a goal of issuing final standards by the end of the year.

In this edition of *The quarter close***,** we highlight these and other relevant accounting and reporting topics you should consider as you close out the third quarter of 2023.





Accounting and reporting hot topics

Ask the National Office: New cybersecurity disclosure rule

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What is changing as a result of the new rule?

The SEC's new rule will require registrants reporting under the Exchange Act of 1934 to make timely disclosure of material cybersecurity incidents and annual disclosures about cybersecurity risk management, strategy, and governance. The new rule also has comparable requirements for foreign private issuers. Prior to the new rule there was no disclosure requirement specifically related to cyber. The SEC decided to provide more explicit requirements to enhance and improve the consistency of disclosures, especially as cyber incidents have become more prevalent.

What disclosures are required if a cyber incident occurs?

Beginning December 18, 2023 (or June 15, 2024 for smaller reporting companies), registrants will be required to disclose information in a Form 8-K about a material cyber incident, or a series of related incidents, within four business days after the incident is determined to be material.

The 8-K is required to describe the nature, scope, and timing of the incident and the material impact or reasonably likely material impact on the registrant, including its financial condition and results of operations. Companies do not need to disclose specific or technical information about their planned response to the incident or their systems that would impede their response or remediation of the incident. If information is not determinable or is unavailable at the time of the required filing, companies are required to file an amendment when that information becomes available.

Cyber incidents that occur on third-party information systems used by the company must also be evaluated to determine if they are material to the company. If so, companies should prepare the 8-K based on the information available to them.

What is a "material" cyber incident?

As used in the new rule, materiality is consistent with how that term is set out in the federal securities laws as well as numerous court cases. The Supreme Court has deemed information to be material if there is a "substantial likelihood that a reasonable investor would consider it important" or if it would have "significantly altered the 'total mix' of information made available."

There is often a high degree of judgment in making a materiality determination. Companies will need to conduct an objective analysis of both quantitative and qualitative factors, and evaluate the incident's known and reasonably likely impacts. Examples of qualitative factors include harm or potential harm to a company's reputation, competitiveness, or customer and vendor relationships.

What are the new annual disclosures?

The rule requires annual disclosures in Form 10-K about the registrant's processes, if any, for assessing, identifying, and managing material risks from cyber threats. Companies are also required to describe whether any risks from those threats, including as a result of previous cyber incidents, have materially affected or are reasonably likely to materially affect the registrant. Lastly, companies are required to describe their governance of cyber risks, including management's role and the board of directors' oversight. These disclosures are required beginning with annual reports for fiscal years ending on or after December 15, 2023.

What can companies do now to prepare?

Companies will need to assess whether their existing processes measure up against the new requirements for incident reporting. Getting the right information timely is critical and companies should consider whether they have communication processes in place between IT, finance, and legal to make materiality determinations without unreasonable delay after discovery of an incident. Companies should also assess their processes for recordkeeping of cyber incidents and evaluating whether immaterial incidents are related and material in the aggregate. To prepare for the annual disclosures, companies should inventory the relevant aspects of their cyber risk management, strategy, and governance, and validate whether the information is accurate and "disclosure-ready."

> For more information and resources, refer to our SEC's new cyber disclosure rule landing page on pwc.com.

Spotlight on debt restructurings

Debt modifications and restructurings continue to be a hot topic as companies contending with economic uncertainty face impending maturity dates, covenant violations, cash flow constraints, payment defaults, or changes in underlying collateral values. The accounting impact of a debt restructuring depends on the surrounding facts and circumstances, and requires companies to navigate accounting guidance that can be complex. Below are some key reminders when accounting for a debt restructuring.

Determining the relevant accounting model

When debt is restructured with the same lender, a company should first assess whether a troubled debt restructuring has occurred. This is important because the accounting for a troubled debt restructuring can differ significantly from the accounting for a non-troubled debt restructuring. For a debt restructuring to be considered troubled, a company must be experiencing financial difficulties and the lender must grant a concession.

If the transaction is not considered troubled, the next step is to determine whether the transaction is a debt extinguishment or modification. This determination should be based on the economic substance of the transaction, regardless of its legal form. The analysis requires a present value calculation to determine if the change in contractual cash flows between the original debt and the restructured debt is 10% or greater. This assessment has nuances that can often be overlooked. For example, changes in principal amounts should be treated as day-one cash flows. In addition, if the debt is callable (pre-payable) or puttable, then separate cash flow analyses should be performed assuming exercise and nonexercise, and the scenario with the smallest change should be used. A prepayment option is a common type of call option in variable rate debt.

If the change in cash flows is 10% or more, the restructuring is accounted for as an extinguishment; otherwise, it is a modification. The difference between the two outcomes is summarized as follows:

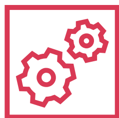
Type of transaction	Debt	New lender fees	New third-party fees
Extinguishment	A gain or loss is recorded for the difference between the net carrying value of the original debt and the fair value of the restructured debt.	Expense	Capitalize
Modification	No gain or loss is recorded. A new effective interest rate is established based on the carrying value of the debt and the restructured cash flows.	Capitalize	Expense

Classification and disclosure considerations

Debt that is nearing its maturity date or is subject to certain acceleration clauses or other covenants should also be considered as part of management’s disclosures about liquidity risk, its going concern assessment, and assessment of balance sheet classification. Compliance with debt covenants and the classification of debt should generally be assessed based on the facts and circumstances at the balance sheet date. However, in certain circumstances, subsequent events can impact debt classification. For example, debt restructurings after the balance sheet date, but before issuing the financial statements, may change the terms of the debt (e.g., the amount due within one year after the date of the borrower's balance sheet may change). These restructurings may result in reclassification of all or a portion of the carrying amount of the debt as of the balance sheet date.

For more information

Refer to Chapter 3 of our *Financing transactions* guide for more guidance on debt restructuring transactions and Chapter 12 of our *Financial statement presentation* guide for more guidance on debt classification. You may also be interested in our podcast, *Debt restructuring in an uncertain economic environment*.



Regulatory developments

New SEC reporting requirements on the horizon

In addition to new cybersecurity disclosures (see *Ask the National Office* for more details), SEC registrants will soon be required to comply with new rules related to the clawback of erroneously awarded executive compensation and share repurchases.

Clawback of erroneously awarded executive compensation

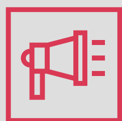
In 2022, the SEC adopted rules directing US securities exchanges to establish standards to require listed issuers to develop and implement a written policy providing for the recovery of incentive-based compensation received by current and former executive officers in the event of required accounting revisions and restatements. The listing standards have now been approved and will take effect on October 2, 2023. Companies will have until December 1, 2023 to adopt a compliant recovery policy; however, the policy must be applied to erroneously awarded compensation received on or after October 2, 2023. For annual reports filed after adopting a recovery policy, companies are required to file their policy as an exhibit and disclose any actions taken pursuant to the policy. Additionally, companies will need to indicate on the cover page of Form 10-K (or Form 20-F) whether the financial statements included in the filing reflect the correction of an error and whether the error correction required an incentive-based compensation recovery analysis. For more background and discussion of the key provisions of the SEC rules, read our In depth, *SEC adopts executive incentive compensation clawback rules*.

Expansion of share repurchase disclosures

As we told you last quarter, the SEC adopted amendments in May that expand existing share repurchase disclosure requirements for domestic corporate issuers, foreign private issuers (FPIs), and listed closed-end funds. The amendments significantly increase disclosures about share repurchases, requiring quarterly reporting of daily repurchase activity, as well as increased reporting regarding the rationale and objectives for share repurchase plans. This quarter we want to remind you that domestic corporate issuers (and FPIs filing on domestic forms) will be required to comply beginning with the filing that covers the first full fiscal quarter beginning on or after October 1, 2023. For example, calendar year-end companies will be required to comply beginning in their December 31, 2023 Form 10-K. FPIs filing on FPI forms and listed closed-end funds will be required to comply in 2024. For more information, read our In brief, *SEC expands share repurchase disclosures*.

SEC adopts rules impacting private funds and advisers

In August, the SEC adopted sweeping reforms of regulations over investment advisers and the private funds they advise. The new rules are expected to have a significant impact on private fund disclosures, reporting, fees and expenses, and operations. For more information, including the effective dates of the various requirements, read our In brief, *SEC adopts rules impacting private funds and advisers*.



Climate disclosure bills pass in California

Not content to wait for the SEC's final climate disclosure rule, the California Legislature passed sweeping new climate disclosure requirements for US companies, including subsidiaries of non-US companies, that "do business" in the state, as defined, that meet certain revenue thresholds.

Two bills, Climate Corporate Data Accountability Act (SB 253) and Greenhouse gases: climate-related financial risk (SB 261), were sent to Governor Gavin Newsom days before the end of the legislative session. Unless vetoed, they will become law on October 14.

SB 253 would require scope 1, scope 2, and scope 3 greenhouse gas emissions reporting in compliance with the Greenhouse Gas Protocol. It includes a phased-in requirement for third-party assurance. SB 261 would require climate-related financial risk reporting following the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD). The laws would require reporting on 2025 information in 2026, so companies need to start to prepare now. For more information, refer to our In the loop, *California's not waiting for the SEC's climate disclosure rules*.

Significant milestones achieved in global sustainability reporting

This quarter brought notable developments in global sustainability reporting, with two major milestones reached – adoption of the final sustainability reporting standards in Europe and issuance of the first two standards from the new international sustainability standard setter.

Corporate Sustainability Reporting Directive (CSRD)

In July, the European Commission adopted the final European Sustainability Reporting Standards (ESRS). Those standards detail the reporting requirements under the CSRD, and cover environmental, social, and governance topics. The 12 final standards will now face scrutiny from the European Parliament and Council of the European Union (for two months with a possible two-month extension) before going into effect. The ESRS are not subject to separate transposition into law by the EU Member States; they will become law shortly after the scrutiny period ends when they are published in the Official Journal of the European Union. For more information, read our In brief, *Final European Sustainability Reporting Standards have been adopted*.

Meanwhile, the European Financial Reporting Advisory Group (EFRAG) continues work on a number of items. In September, EFRAG discussed its progress on the development of implementation guidance, specifically related to the double materiality and the value chain assessments, which will be released for public comment in the coming weeks. In addition, EFRAG is working with the Global Reporting Initiative (GRI) and the International Sustainability Standards Board (ISSB) to prepare mapping tables depicting the final ESRS' interoperability with the GRI standards and the IFRS® Sustainability Disclosure Standards.

Since the CSRD went into effect in January 2023, EU Member States have begun the process of transposing it into their own national laws. Public consultations have been held in a number of countries to seek input from stakeholders, and drafts of the legislation have been made available or will be released in the coming months (with final transposition required by July 2024). The extent of any changes that may occur during the transposition process, however, is still unclear. Companies should monitor developments in those EU Member States where they have subsidiaries.

US companies can be subject to these sustainability reporting requirements in multiple ways, and the first set of companies in scope will be required to make disclosures in 2025 about 2024 information. For more details, read our In the loop, *Worldwide impact of CSRD - are you ready?*.

International Sustainability Standards Board (ISSB)

The ISSB issued its first two IFRS Sustainability Disclosure Standards, covering general requirements (IFRS S1) and climate (IFRS S2), in June. IFRS S1 and IFRS S2 are effective for periods beginning on or after January 1, 2024, which could mean reporting as early as 2025. The ISSB provided transition relief, however, requiring only climate-related disclosures in the first year of reporting. Thus, companies would be required to provide disclosures in accordance with IFRS S2, as well as the general disclosures under IFRS S1, only to the extent they relate to climate risks and opportunities.

Individual jurisdictions will determine if application of the Sustainability Disclosure Standards is required or permitted as a basis for sustainability reporting, akin to the process for adopting IFRS Accounting Standards for financial reporting. The International Organization of Securities Commissions (IOSCO) announced on July 25 that it endorses the IFRS Sustainability Disclosure Standards. IOSCO has now called on its 130 member jurisdictions, regulating more than 95% of the world's financial markets, to consider ways in which they might adopt, apply, or otherwise be informed by the ISSB™ standards in their jurisdictions. We expect these and other efforts around the world to accelerate with the release of the final standards. For more information, read our In depth, *IFRS Sustainability Disclosure Standards – Guidance, insights, and where to begin*.

For more information

For details about how the European Commission's and ISSB's sustainability reporting frameworks compare to the SEC's proposed climate rule, refer to our updated In the loop, *Navigating the ESG landscape*.

Standard-setting updates

FASB greenlights issuance of three significant new standards

In the third quarter, the FASB made final decisions on three major projects: (1) segment reporting, (2) income tax disclosures, and (3) accounting for and disclosure of crypto assets. All three final standards are expected to be issued before the end of the year.

Segment reporting

The new segment reporting standard will add required disclosures of significant expenses for each reportable segment, as well as certain other disclosures to help investors understand how the chief operating decision maker evaluates segment expenses and operating results. The new standard will also allow disclosure of multiple measures of segment profitability, if those measures are used to allocate resources and assess performance. The guidance will be effective for calendar-year-end public companies in the 2024 annual period and in 2025 for interim periods, with early adoption permitted. For more information, refer to the FASB's project page.

Income tax disclosures

The new income tax standard will require significant additional disclosures, primarily focused on the disclosure of income taxes paid and the rate reconciliation table. At its August 30 meeting, the FASB affirmed many of its previous decisions as reflected in the exposure draft issued earlier this year. Notable changes from the proposal include removing the requirement to disclose a disaggregation of income taxes paid in interim periods and permitting companies to present an aggregate total of changes in unrecognized tax benefits for all jurisdictions within the rate reconciliation table. While the FASB clarified its intent that items within the rate reconciliation should be presented on a gross basis, the FASB decided to allow companies to present certain items within the cross-border tax-effects category net of their foreign tax credits. The new guidance will be applied prospectively (with retrospective application permitted) and will be effective for calendar-year-end public business entities in the 2025 annual period and in 2026 for interim periods, with early adoption permitted. All other entities will have an additional year to adopt the new guidance. For more information, refer to the FASB's project page.

Accounting for and disclosure of crypto assets

The new standard on crypto assets will provide accounting and disclosure guidance for crypto assets that meet the definition of an intangible asset and certain other criteria, including the asset does not provide the holder with enforceable rights to, or claims on, underlying goods, services, or other assets. In-scope assets will be subsequently measured at fair value with changes recorded in the income statement. The standard will require separate presentation of (1) in-scope crypto assets from other intangible assets and (2) changes in the fair value of those crypto assets. Disclosure of significant crypto asset holdings and an annual reconciliation of the beginning and ending balances of crypto assets will also be required. Companies will apply the new guidance by making a cumulative-effect adjustment to the opening balance of retained earnings as of the beginning of the annual period the guidance is adopted. The guidance will be effective for all calendar-year-end companies in 2025, including interim periods, with early adoption permitted. For more information, refer to the FASB's project page.

FASB issues final standard on accounting for joint venture formations

In August, the FASB issued ASU 2023-05, which requires a joint venture to initially measure all contributions received upon its formation at fair value. This accounting will largely be consistent with ASC 805, *Business Combinations*, although there are some specific exceptions. This new guidance is intended to reduce diversity in practice and provide users of the joint venture's financial statements with more decision-useful information. It may also reduce the amount of basis differences that an investor in a joint venture needs to track. The standard is effective for all joint venture entities with a formation date on or after January 1, 2025, with early adoption permitted. Joint ventures formed prior to the adoption date may elect to apply the new guidance retrospectively back to their original formation date. For more information, refer to our In depth, *FASB issues guidance on accounting for joint venture formations*.

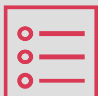
Proposal would require new disclosures disaggregating income statement expenses

In July, the FASB issued a proposal intended to improve disclosures about a public business entity's expenses and address requests from investors for more detailed information about the types of expenses in commonly presented income statement expense captions. The proposal would require public companies to provide disclosure in a tabular format that disaggregates income statement expense line items into specified categories of natural expenses, including: (a) employee compensation, (b) inventory and manufacturing expense, (c) depreciation, and (d) intangible asset amortization. Other items not covered by these categories would be qualitatively described in the disclosure. Companies would also be required to further disaggregate inventory and manufacturing costs incurred during the period. Lastly, the proposal would require separate disclosure of total "selling expenses" for the reporting period.

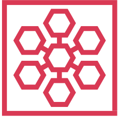
The proposed amendments would be applied on a prospective basis with retrospective application permitted. Comments on the proposal are due October 30 and the FASB plans to host a public roundtable on December 13 to obtain additional feedback.

FASB proposes changes to the accounting for purchased financial assets

In June, the FASB issued a proposal that would require all financial assets acquired in a business combination and all "seasoned" financial assets acquired in an asset acquisition to follow the "gross-up approach" in ASC 326, *Credit Losses*, with no credit loss recorded upon acquisition. The amendments would remove the requirement for entities to determine whether purchased financial assets have experienced a more-than-insignificant deterioration in credit quality since origination; however, it would introduce seasoning criteria to determine whether an acquired financial asset is an in-substance origination. The proposal would not amend the accounting for originated financial assets or acquired financial assets that are not "seasoned." The amendments would be applied on a modified retrospective basis. Comments on the proposal were due August 28.



For a complete list of recently issued accounting standards and their effective dates, including links to 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.



PwC reference library

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Listen to our August accounting podcasts to brush up on financial instruments hot topics, including investment securities, CECL, convertible instruments, and earnings per share. In September, we shift our focus to providing updates on the global economy and supply chain.

Some of our most popular podcasts this quarter:

Accounting for business combinations: Being prepared for a deal

Talking ESG: What's inside the final ISSB standards

Talking ESG: Preparing for the EU's Foreign Subsidies Regulation

Navigating SEC filing requirements for a business combination

Investment securities: 5 things you need to know

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In depths

FASB issues guidance on accounting for joint venture formations

IFRS Sustainability Disclosure Standards – Guidance, insights and where to begin

Not-for-profits and the Current Expected Credit Loss (CECL) model

Accounting for Inflation Reduction Act energy incentives

PCAOB proposes significant expansion of auditor responsibilities

OECD Pillar Two: Time to act on the global minimum tax

FASB changes accounting for tax credit investments

Accounting in uncertain economic times placemat series

In briefs

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Final European Sustainability Reporting Standards have been adopted

SEC adopts cybersecurity disclosure rules

IFRS Sustainability Disclosure Standards have been released

The ISSB has released its request for information on agenda priorities

SEC expands share repurchase disclosures

FASB staff weighs in on tax accounting for OECD Pillar Two taxes

In the loops

California's not waiting for the SEC's climate disclosure rules

Worldwide impact of CSRD - are you ready?

Navigating the ESG landscape

Measuring year-over-year progress in SEC sustainability disclosures

Global taxation: More than an idea - what it means for you now

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Navigating the new SEC rules on cyber disclosures

Boardroom readiness: Top 5 actions for cyber discussions

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