A look at this quarter's financial reporting matters

In this edition:

Introduction

As we head into the summer months, a return to "normal" may seem elusive for many companies given ongoing geopolitical and economic uncertainties. In a special edition of Ask the National Office, we ask PwC's Deputy Chief Accountants for their thoughts on what should be top of mind when considering accounting and reporting in the current environment. Also, a must read when drafting your second quarter disclosures is the SEC's new "Dear CFO" letter, which focuses on impacts of the Russian government's invasion of Ukraine.

Looking forward, comments are in on the SEC's high profile climate and cyber disclosure proposals and the staff will now turn to reviewing the feedback and drafting final rules. Meanwhile, the SEC isn't slowing down on proposed rulemaking; this quarter saw new proposals on SPAC transactions and ESG-related disclosures for funds and investment advisors. Global regulators have also moved forward on their ESG reporting initiatives, issuing draft standards for comment.

On the standard-setting front, the FASB has added new crypto and ESG-related projects to their agenda–stay tuned as deliberations begin on these projects in the upcoming months. This quarter we also spotlight the FASB's recent decision to refocus its project on income tax disclosures.

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 second quarter of 2022.

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Accounting and reporting hot topics

Ask the National Office: Accounting impacts of macroeconomic trends

As we pass the midpoint of 2022, companies continue to face multiple challenges and uncertainties, including the impacts of geopolitical events, supply chain disruptions, inflation, rising interest rates, and market volatility. For this special edition of Ask the National Office, we asked three of PwC's Deputy Chief Accountants to weigh in on the related accounting and reporting implications.

Considering the current geopolitical and macroeconomic landscape, what are some of the accounting and reporting implications companies should be thinking about this quarter?

Bret Dooley (financial instruments):

Ongoing volatility and uncertainties continue to make it challenging to apply the current expected credit losses, or CECL, model for financial instruments. As a reminder, CECL requires companies to consider current conditions as well as reasonable and supportable forecasts in developing an estimate of expected credit losses. Companies should update their models and estimates to reflect revised economic outlooks, perform sensitivity analyses based on new forecasts, adjust probability weighting of alternative scenarios, and consider qualitative adjustments. Companies should also consider additional disclosures about the impact of the current economic environment, including assumptions used and their impact on the estimate for credit losses.

Financial instruments not subject to CECL may also be impacted. For example, companies that own equity instruments accounted for using the measurement alternative in ASC 321 must consider whether fair value is below carrying amount, even if there have been no observable transactions. A decline in fair value below carrying amount would result in recording an impairment. ASC 321 does not have a significance threshold or a concept of "temporary declines" with respect to impairment assessments. In addition, with the increases in interest rates, companies that own debt securities accounted for as available for sale should review securities with a fair value less than amortized cost and recognize an impairment if the company has an intent to sell security, or it is more likely than not that the company will be required to sell the security, prior to expected recovery of the amortized cost basis.

Companies using hedging strategies to lock in costs will need to ensure they have met the eligibility, effectiveness, and other documentation requirements, especially if they are new to hedge accounting. Those already using hedge accounting will need to consider whether hedged forecasted transactions remain probable of occurring--particularly in light of supply chain challenges that exist.

Beth Paul (business combinations, consolidations, non-financial assets):

We continue to receive questions from companies that have operations in jurisdictions impacted by the war in Ukraine. These include whether consolidation continues to be appropriate given any government regulations and the related impact on a company's decision making authority, and the implications of decisions to exit operations in the region, including whether the criteria for held-for-sale accounting have been met.

Additionally, impacts from the war in Ukraine may result in a triggering event that requires assessing goodwill, indefinite-lived intangibles, and/or long-lived assets for impairment. Each of these asset types has its own model for impairment testing, so it is important to identify which guidance is applicable. While judgment is required, macroeconomic conditions (e.g., market volatility) can also be a trigger for performing an impairment test. Each company will have to assess its own facts and circumstances, and should consider disclosure of the significant judgments applied.

Pat Durbin (revenue, inventory, compensation):

As supply chain disruptions and inflation put stress on margins, companies should provide transparent disclosures and/or management commentary about how the business is impacted by these trends. Companies that are unable to pass along rising costs to customers will need to consider the impact to the net realizable value of inventory. This margin pressure may be even more acute for companies that utilize a “last-in-first-out” or LIFO method of inventory costing.

In the current environment, robust processes and controls to update estimates are critical since it will often not be sufficient to solely rely on historical data. For revenue contracts, this includes estimates of variable consideration and measures of progress on long-term contracts, among other estimates. Fixed price contracts should also be reassessed for possible losses due to cost increases.

Lastly, keep in mind that multiple areas of GAAP involve the use of assumptions (e.g., interest rates, estimated share price volatility, estimates of future taxable income) that may need to be adjusted given current developments. This includes, but isn’t limited to, measuring pension obligations, assessing realizability of deferred tax assets, and measuring fair value of stock option awards.

Watch the replay of our *Q2 2022 Quarterly accounting* webcast for an update on macroeconomic trends from Zain Siddiqui, Senior Economist for PwC Intelligence.

“Dear CFO” letter spotlights disclosures related to the war in Ukraine

The Russian government’s invasion of Ukraine continues to have a profound impact on business operations within the conflict zone as well as on markets worldwide. In May, the SEC’s Division of Corporation Finance issued an illustrative letter with sample comments the Division may issue to registrants, reinforcing disclosure obligations related to matters that directly or indirectly impact a company’s business. The letter provides a useful reminder of the SEC’s disclosure expectations as companies prepare their quarterly disclosures and could be relevant more broadly to matters such as supply chain disruptions, inflation, and market volatility.

While not an exhaustive list, topics addressed in the letter include:

- Direct and indirect impact of the Russian government’s invasion on a company’s business, such as government actions (including expropriation), reaction of investors, employees, and/or other stakeholders
- The extent and nature of the board of directors’ role in overseeing risks
- Cybersecurity
- Disclosure of known trends or uncertainties, including impairment of tangible and intangible assets, contract modifications, and recoverability and collectability issues
- Enhancements needed to critical accounting estimates disclosures
- Disclosure of any material import or export bans
- Supply chain impacts, including by segments, products, lines of service, projects, or operations
- Use of non-GAAP measures
- Disclosure controls and procedures and internal control over financial reporting

For more information on the potential accounting and reporting impacts, read our In depth, *Implications of the Russian government’s invasion of Ukraine*, and listen to our four-part podcast series.

The SEC also continues to issue comments on climate-related disclosures, highlighted in the staff’s September 2021 “Dear CFO” letter. Refer to *Regulatory developments* for more ESG updates.

Navigating the accounting for business disposals

Business disposals continue to be a hot topic as companies reevaluate their portfolios. Further, the war in Ukraine, as well as the economic sanctions imposed on Russia, has caused many businesses to reconsider the feasibility of their operations within these jurisdictions. Decisions to dispose of assets and business operations may have significant accounting and reporting implications.

Held-for-sale criteria

Long-lived assets are classified as “held for sale” when they meet certain criteria in ASC 360-10-45-9, including management’s commitment to a disposal plan. The criteria also require that the sale must be probable within one year, which is a frequent area of judgment.

Questions have recently arisen regarding the impact of put and call options, as companies contemplate structures that might allow them to regain control of a disposed business if economic and political conditions improve. A put or call option may preclude sale accounting for long-lived assets as it may indicate that either a seller has not yet relinquished control or a buyer has not yet gained control of the assets. Relevant guidance on this aspect can be found in ASC 810 for disposals of a business and ASC 610-20 for disposals of assets that do not constitute a business.

Recognition and measurement considerations

An asset (or group of assets) that meets the held for sale criteria should be recorded at the lower of its carrying value or its fair value less cost to sell, beginning in the period the held for sale criteria are met. Once classified as held for sale, depreciation and amortization should not be recorded for any long-lived assets included in the disposal group.

Additional losses should be recognized for any subsequent decreases in fair value less cost to sell. Any subsequent increase in the disposal group’s fair value less cost to sell should be recognized, but not in excess of the cumulative loss previously recognized.

Groups of assets classified as held for sale should be presented separately on the balance sheet. The assets and liabilities are not netted; rather, they are typically grouped into four categories: current assets held for sale, long-term assets held for sale, current liabilities held for sale, and long-term liabilities held for sale. The prior period balance sheet is not required to be recast unless the disposal group qualifies for treatment as discontinued operations.

Other reminders

Discontinued operations: Depending on the significance of the assets or group of assets that meet the held-for-sale criteria, and whether the disposition constitutes a strategic shift in the company’s operations, the disposal may qualify as a discontinued operation. This triggers additional presentation and disclosure requirements, including recasting prior periods to separately present discontinued operations on a net-of-tax basis and calculating a separate earnings per share amount.

Income tax considerations: A decision to sell the shares of a subsidiary could require the recognition of additional deferred tax assets or liabilities associated with the difference between the seller’s carrying amount of the subsidiary’s net assets in the financial statements and the seller’s basis in the shares of the subsidiary (otherwise known as “outside” basis differences). There could also be impacts on a company’s valuation allowance analysis even before committing to a plan of disposal. Listen to our podcast, *Tax toolkit: Navigating divestitures effectively*, for more details.

For more information

Read more about the held-for-sale model in Chapter 5 of our *Property, plant, equipment and other assets* guide and Chapter 8 of our *Financial statement presentation* guide. For more details on discontinued operations, refer to Chapter 27 of our *Financial statement presentation* guide and listen to our podcast, *Discontinued operations, your reporting questions answered*.

SEC guidance on safeguarding crypto effective this quarter

The SEC staff released new interpretative guidance effective this quarter for companies that engage in activities in which they have an obligation to safeguard customers' crypto assets, citing the “unique risks and uncertainties” present in these arrangements. Staff Accounting Bulletin No. 121 (SAB 121) requires companies that perform crypto asset custodial activities, whether directly or through an agent acting on its behalf, to record a liability and a corresponding asset at fair value. It also requires disclosure of the nature and amount of crypto assets the reporting entity is responsible for safeguarding for its customers.

Determining whether the guidance is applicable to a company’s specific facts and circumstances could require significant judgment. SEC registrants are expected to comply with the guidance in the first interim or annual financial statements ending after June 15, 2022 (e.g., Q2 2022 for calendar year-end public companies), and apply it retrospectively to the beginning of the year. Certain other specified entities are also in the scope of the new interpretive guidance.

For more information, read our In depth, *Perspectives on SAB 121 and safeguarding crypto assets*.

Modifications to LIBOR contracts – not all will qualify for accounting relief

As the end of LIBOR draws closer, many companies will need to modify or replace existing arrangements that reference LIBOR. To provide relief during the period of transition away from LIBOR, the FASB issued ASC 848, *Reference rate reform*. This guidance generally simplifies the accounting for a contract modified solely to change the reference rate (e.g., LIBOR) as a result of reference rate reform. In April, the FASB proposed extending the sunset date of this guidance to December 31, 2024.

Companies modifying their contracts will need to carefully assess the provisions of ASC 848 before concluding the accounting relief will apply to the modification. For example, to qualify for the relief relating to contract modifications, the modification cannot modify terms that change, or have the potential to change, the amount and timing of cash flows unrelated to the replacement of LIBOR. ASC 848 also provides expedients to alleviate the impact of reference rate reform on the application of hedge accounting. However, companies will need to evaluate the nature of changes being made to the hedge relationship and whether there is a specific provision in the guidance providing an expedient. Modifications and transactions that do not qualify for the expedients in ASC 848 will need to be evaluated under the relevant guidance, which can be complex.

For more information, read our *Reference rate reform* guide and listen to our podcast, *LIBOR transition past, present, and future*.

Regulatory developments

SEC's landmark climate disclosure proposal moves to the next phase

Now that the comment period for the SEC's climate disclosure proposal has come to a close, the SEC staff will review the feedback and draft final rules for vote by the Commissioners.

As proposed, new disclosures would be required for all public companies and would include certain climate-related financial metrics in the audited financial statements. Companies would also be required to disclose information about greenhouse gas emissions, which would be subject to a phased-in assurance requirement (for large accelerated and accelerated filers). The disclosure requirements would be phased based on registrant type. If the rules are adopted and become effective in 2022, large accelerated filers would be required to provide the new disclosures first in 2023 (Form 10-Ks filed in 2024).

While some of the proposed requirements are likely to evolve as a result of the rule-making process, there are several actions companies can, and should, take now to prepare for adoption. Read or listen to our In the loop, *The SEC wants me to disclose what?* for PwC's insights on the proposal and steps companies should take today.

In the meantime, the SEC continues to enforce the current requirements for climate-related disclosures through comment letters–and enforcement actions. Revisit our In the loop, *Don't wait until the SEC staff asks you about climate change*, for reminders and example SEC comments.

> "Today, investors representing literally tens of trillions of dollars support climate-related disclosures because they recognize that climate risks can pose significant financial risks to companies."
>
> **— SEC Chair Gary Gensler**

Global regulators make progress on ESG proposals

In addition to the SEC's climate disclosure proposal, the International Sustainability Standards Board (ISSB) and European Financial Reporting Advisory Group (EFRAG) have issued key ESG disclosure proposals.

ISSB proposes two sustainability standards

In March, the ISSB issued its first two proposals for new sustainability standards, addressing general and climate-related disclosures. The ISSB sits alongside the IASB and works in close cooperation to establish complementary standards. The standards are intended to provide a global baseline for ESG reporting, and the ISSB will work with other international organizations and jurisdictions to support the inclusion of the global baseline into jurisdictional requirements. Each country will determine whether and when ISSB standards should be adopted locally. Comments on the proposals are due by July 29, and final standards are expected before the end of the year. For more information, read our In brief, *ISSB proposes two sustainability standards*.

EFRAG begins public consultation on its draft sustainability reporting standards

In April, the EFRAG announced the start of public consultation on its first set of exposure drafts developed under the Corporate Sustainability Reporting Directive (CSRD). The exposure drafts cover the full spectrum of sustainability matters: environment, social, and governance. As currently proposed, the CSRD would require certain companies in the EU, including EU subsidiaries of US companies, to report in granular detail on: (1) how sustainability issues affect their business and (2) the impact of their activities on people and the environment; this is referred to as "double materiality" and differs from the SEC's and ISSB's definitions of materiality that are viewed through an investor lens. Comments on the proposals are due by August 8. For more information, including the impact of the CSRD on US companies, read our In the loop, *Why US companies should not ignore Europe's ESG proposals*.

Listen to our podcast, *ESG disclosures: What matters to investors*, to hear PwC's investor engagement specialists discuss the "big three" disclosure proposals from the SEC, ISSB, and EFRAG.

New ESG-related proposals for funds and investment advisers

On the heels of announcing its first major enforcement action related to ESG investment disclosures, the SEC issued two new proposals for funds and investment advisers. The first proposal would enhance disclosures for certain registered investment companies and investment advisers that consider ESG factors in their portfolios. The proposed amendments would require disclosures about ESG strategies in fund prospectuses, annual reports, and adviser brochures, and would require certain environmentally focused funds to disclose the greenhouse gas emissions associated with their portfolio investments.

The SEC also proposed amending its Rule 35d-1 under the Investment Company Act of 1940, commonly referred to as the "Names Rule," which currently requires certain funds to invest at least 80% of their assets in the type of investment, or in investments in the industry, country, or geographic region, suggested by its name. The proposed amendments would significantly expand the scope of the rule to any fund name with terms suggesting the fund focuses on investments with particular characteristics, including any term that suggests the fund meets certain ESG criteria, such as "sustainable" or "green."

Comments on both proposals are due August 16. For more information, read our In brief, *SEC proposals on fund and adviser ESG disclosures and fund names*.

Comment period ends for cyber proposal

The comment period closed in early May for the SEC's cybersecurity disclosure proposal. As a reminder, the proposed amendments would require reporting of material cybersecurity incidents within four business days of determining the incident is material. The proposed amendments would also require disclosure of policies and procedures for managing cyber risk, along with information on board oversight of cybersecurity risks and whether the board has expertise on cybersecurity. Further highlighting the SEC's focus on the topic, the SEC announced in May that it nearly doubled its Crypto Assets and Cyber Unit, the unit in charge of identifying cyber-related disclosure and controls issues.

Feedback on the proposal–numbering around 135 responses–generally supported enhanced and standardized disclosures about cybersecurity; however, many respondents asked for clarification or changes to key areas of the proposal, most notably for clarity about which incidents are in scope and to coordinate the timing of disclosure with other agencies or law enforcement when applicable.

Although final rules are still pending, companies shouldn't put off assessing their controls over cybersecurity risks and ensuring coordination across the organization–including the finance, information technology, legal, and reporting functions–on this important topic. For more details on the SEC's proposal, read our In brief, *SEC proposes new cybersecurity disclosure requirements*, and listen to our podcast, *New SEC cyber proposal: How could it change current reporting?*

SEC proposes rules for SPAC and de-SPAC transactions

After the recent surge in special purpose acquisition company (SPAC) activity, the SEC has proposed new rules and amendments that would impact SPAC IPOs and the subsequent merger between a SPAC and private operating company (de-SPAC). The proposed rules seek to provide SPAC investors with the same level of protection as traditional IPOs and would require enhanced disclosures. Comments on the proposal were due June 13. For more information, read our In brief, *SEC proposes new rules related to SPAC and de-SPAC transactions*.

ICYMI: OECD proposed rules on global minimum tax

In December 2021, the Organisation for Economic Co-operation and Development (OECD) published a highly anticipated "two pillar" model rule for domestic implementation of a 15% global minimum tax. For details on the implications and how companies can prepare, listen to our recent podcast, *Global minimum tax: It could be closer than you think*.

Standard-setting updates

FASB issues new standards on hedge accounting and CECL

Recently issued accounting standards, which are available for early adoption in certain circumstances, include:

- ASU 2022-01, *Fair value hedging–portfolio layer method*: A follow-on to hedge accounting amendments issued in 2017, this guidance expands the current single-layer method to allow multiple hedged layers of a single closed portfolio under the method.
- ASU 2022-02, *Troubled debt restructurings and vintage disclosures*: This amendment to the CECL guidance eliminates the troubled debt restructuring guidance for creditors and adds new disclosure requirements. Read our In depth for more information.

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.

FASB votes to remove two projects from its agenda

At its June 15 meeting, the FASB voted to remove its project on the subsequent accounting for goodwill from its technical agenda. The FASB had been considering standard setting that would require amortization of goodwill, which received mixed feedback from stakeholders. Board members cited consideration of costs versus benefits as the primary reason to remove the project. The FASB also decided to discontinue its project on aligning the accounting for asset acquisitions and business combinations.

Invitation to comment seeks input on government grants

On June 13, the FASB issued an invitation to comment to solicit feedback on whether certain requirements of IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, should be incorporated into US GAAP. The guidance in IAS 20 is often applied by business entities by analogy as no specific guidance on the recognition and measurement of government grants received by business entities currently exists in US GAAP. Comments on the invitation to comment are due September 12.

FASB adds projects on digital assets and environmental credits

The FASB voted this quarter to take on two projects addressing emerging issues. The first project will address the accounting for digital assets, with decisions on scope to be made at a future meeting. The second project will consider the accounting for environmental credits, such as renewable energy credits and carbon offsets. Stay tuned as the FASB begins deliberating these projects in the upcoming months.

Project spotlight

Income tax disclosure project gets a reboot

This spring, the FASB revisited the scope and objectives of its income tax disclosure project and decided to primarily focus on two topics:

- **Income taxes paid**: The FASB voted to explore disaggregation of taxes paid by jurisdiction, for example by top jurisdictions or using a quantitative threshold.
- **Rate reconciliation table**: The FASB voted to explore both a quantitative threshold approach (e.g., leveraging the SEC's current 5% rule) and an approach that would prescribe specific categories for disclosure of individual reconciling items in the rate reconciliation table, such as the foreign tax differential by jurisdiction.

The FASB directed its staff to continue research and outreach efforts and will begin making decisions at a future meeting.

PwC reference library

PwC's accounting podcasts

PwC's accounting podcast series includes a library of podcasts covering today's most compelling accounting, reporting, and business issues. Subscribe to our podcast feed on your platform of choice.

In our Toolkit podcast series, we are taking a deep dive into one accounting topic each month that goes beyond the basics and into areas that require judgment. In June, we're focused on leases, and you'll want to revisit our past toolkits on revenue, crypto, and income taxes.

Some of the most popular podcasts from this quarter:

SEC climate proposal: A closer look

SEC climate disclosure proposal: Legal and regulatory perspectives

Crypto toolkit: Getting smarter on digital assets

Crypto toolkit: Accounting for holding digital assets

Russian invasion of Ukraine: Accounting for indirect impacts

Accounting and reporting webcasts

Register for our Quarterly accounting and reporting webcast to earn CPEs while staying up to date on key accounting and financial reporting matters each quarter.

Some of our other recent webcasts:

PwC's Q2 2022 quarterly ESG webcast (CPE-eligible replay available soon)

ESG accounting and reporting fall webcast series (CPE-eligible replays)

In depths

Perspectives on SAB 121 and safeguarding crypto assets

Amendments to CECL eliminate TDRs and add disclosures

Implications of the Russian government's invasion of Ukraine

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How CISOs and boards can prepare for the new era of cyber transparency

Purpose driven leadership: the evolving role of ESG metrics in executive compensation plans

Ramping up board effectiveness: Why private company boards need outside directors

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