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Accounting, financial reporting, and regulatory developments

FIRST QUARTER 2023

In this update, we highlight some of the more important 2023 first quarter accounting, financial reporting, and regulatory developments that may impact both public and private companies. The content is not meant to be all-inclusive.

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Accounting guidance

Accounting guidance issued in first quarter 2023

ASU 2023-01: Leases (Topic 842): Common Control Arrangements addresses two common issues raised by private company stakeholders related to the accounting for leasing arrangements between entities under common control. The first issue relates to determining what terms are legally enforceable in common control lease arrangements. The amendments in ASU 2023-01 allow private companies and not-for-profit entities that are not conduit bond obligors to elect a practical expedient to use the written terms and conditions of an arrangement between entities under common control when determining whether the lease exists and the classification and accounting for that lease. These written terms must be completed prior to financial statement issuance in order to be considered effective during the reporting period.

The second issue relates to accounting for leasehold improvements between entities under common control. ASC 842 generally requires entities to amortize leasehold improvements over the shorter of the lease term and the useful life of the assets. ASU 2023-01 changes the requirement for leasing arrangements between entities under common control and requires all entities (both public and private) to amortize leasehold improvements between entities under common control over the useful life of assets to the common control group, even if that's longer than the lease term. If a lessee were to cease use of the leasehold improvements prior to the end of the useful life of the leasehold improvements to the common control group, then it would be accounted for as a transfer of assets between entities under common control.

This new guidance is effective for fiscal years beginning after Dec. 15, 2023, including interim periods within those fiscal years. Early adoption is permitted for both interim and annual financial statements that have not yet been made available for issuance. If an entity adopts the amendments in an interim period, it must adopt them as of the beginning of the fiscal year that includes that interim period.

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ASU 2023-02: Investments — Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method expands the situations where entities can make an accounting policy election to account for tax credit investments by applying the proportional amortization method. Previously, the use of the proportional amortization method was limited to low-income housing tax credit structures. However, ASU 2023-02 expands this to allow entities to elect this accounting approach for all tax credit investments. Electing the proportional amortization method is an accounting policy election that can be made on a tax-credit-program by tax-credit-program basis.

For public business entities, the amendments are effective for fiscal years beginning after Dec. 15, 2023, including interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after Dec. 15, 2024, including interim periods within those fiscal years. Upon adoption, the new guidance should be applied using either a modified retrospective approach or a retrospective approach. Early adoption is permitted.

Accounting guidance effective first quarter 2023: Public companies

The following standards are effective for public companies beginning with the first quarter of 2023:

ASU 2022-04, Liabilities — Supplier Finance Programs (Subtopic 405-50): Disclosure of Supplier Finance Program Obligations requires a buyer in a supplier finance program to provide disclosures about the arrangement to allow a financial statement user to understand the program's nature, activity during the period, changes from period to period, and potential magnitude. The ASU requires the buyer to disclose the following information:

- *The key terms of the program, including a description of the payment terms and assets pledged as security or other forms of guarantees provided for the committed payments.*
- *For obligations the buyer has confirmed as valid to the finance provider:*
  - *The amount outstanding that remains unpaid by the buyer as of the end of the annual period.*
  - *A description of where those obligations are presented on the balance sheet.*
  - *A roll-forward of those obligations during the annual period.*

While the new guidance is effective for the first quarter of 2023, the roll-forward disclosure requirements are not required to be presented until fiscal years beginning after Dec. 15, 2023. Early adoption is permitted.

ASU 2022-01, Derivatives and Hedging (Topic 815) — Fair Value Hedging — Portfolio Layer Method makes it easier for entities to apply the portfolio layer method to qualify for hedge accounting. The amendments include the following main provisions:

- *Allows multiple hedged layers of a single closed portfolio. This expansion resulted in the last-of-layer method being renamed the portfolio layer method.*
- *Expands the types of financial instruments that can be hedged using the portfolio layer method by allowing nonprepayable financial assets to be included within the closed portfolio being hedged. Previously only nonprepayable financial assets or beneficial interests secured by prepayable financial instruments to be included in the closed portfolio being hedged using the portfolio layer method.*
- *Specifies that eligible hedging instruments in a single-layer hedge may include spot-starting or forward-starting constant-notional swaps, or spot or forward-starting amortizing-notional swaps, and that the number of hedged layers (that is, single or multiple) corresponds with the number of hedges designated.*
- *Provides additional guidance on accounting for and disclosure of hedge-basis adjustments.*
- *Specifies how hedge-basis adjustments should be considered when determining credit losses for the assets included in the closed portfolio.*

ASU 2021-08: Business Combinations (Topic 805) — Accounting for Contract Assets and Contract Liabilities from Contracts with Customers requires entities to recognize and measure contract assets and contract liabilities acquired in a business combination in accordance with ASC Topic 606. This ASU creates an exception to the general principle that assets and liabilities acquired in a business combination should be recorded at fair value.

In general, the acquiree should account for the acquired revenue contracts as if it had originated the contracts. However, because the acquiree may be following a different accounting framework or applying different policies or judgments in evaluating contracts than the acquirer, the acquirer may not be able to solely rely on the acquiree’s carrying value of contract assets and contract liabilities and would instead need to review the acquiree’s analysis to evaluate the accuracy of the acquiree’s conclusions or perform their own analysis under ASC Topic 606.

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ASU 2018-12: Financial Services — Insurance (Topic 944) — Targeted Improvements to the Accounting for Long-Duration Contracts provides updated guidance on the accounting and disclosures for long-duration insurance contracts issued by an insurance entity. The amendments in the new standard are intended to:

- *Improve the timeliness of recognizing changes in the liability for future policy benefits and modify the rate used to discount cash flows.*
- *Simplify and improve the accounting for certain market-based options or guarantees associated with deposit (or account balance) contracts.*
- *Simplify the amortization of deferred acquisition costs.*
- *Improve the effectiveness of the required disclosures.*

The new guidance is effective for SEC registrants that are not smaller reporting entities, for fiscal years beginning after Dec. 15, 2022, and interim periods within those fiscal years. For smaller reporting entities, this ASU is effective for fiscal years beginning after Dec. 15, 2024, and interim periods within fiscal years beginning after Dec. 15, 2025.

Accounting guidance effective for years ended Dec. 31, 2023: Private companies

The following standards are effective for private companies for annual reporting periods ending Dec. 31, 2023; however, private companies that prepare interim financial statements are not required to apply the new guidance until the first interim period in 2024, unless otherwise stated.

ASU 2022-04, Liabilities — Supplier Finance Programs (Subtopic 405-50): Disclosure of Supplier Finance Program Obligations requires a buyer in a supplier finance program to provide disclosures about the arrangement to allow a financial statement user to understand the program's nature, activity during the period, changes from period to period, and potential magnitude. The ASU requires the buyer to disclose the following information:

- *The key terms of the program, including a description of the payment terms and assets pledged as security or other forms of guarantees provided for the committed payments.*

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- *For obligations the buyer has confirmed as valid to the finance provider:*
  - *The amount outstanding that remains unpaid by the buyer as of the end of the annual period.*
  - *A description of where those obligations are presented on the balance sheet.*
  - *A roll-forward of those obligations during the annual period.*

While the new guidance is effective for fiscal years beginning after Dec. 15, 2022, the roll-forward disclosure requirements aren't required to be presented until fiscal years beginning after Dec. 15, 2023. Early adoption is permitted.

ASU 2017-04: Intangibles — Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment eliminates Step 2 from the quantitative goodwill impairment test. Entities are now required to perform the quantitative assessment for goodwill impairment in a one-step process by comparing the fair value of a reporting unit with its carrying value. The amount of impairment is calculated as the difference between the carrying value and the fair value of a reporting unit, limited to the amount of goodwill recognized.

ASU 2016-13: Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments introduces a new impairment model for financial assets recorded at amortized cost. Prior to adoption of ASU 2016-13, entities were required to recognize impairment losses when it is probable that losses have been incurred. This model is commonly referred to as an incurred loss model. ASU 2016-13 introduces a new current expected credit loss model, which requires entities to recognize an estimate of the total lifetime expected credit losses on a financial asset at the time the asset is originated. The new guidance applies to financial instruments recorded at amortized cost, including:

- *Financing receivables*
- *Held-to-maturity debt securities*
- *Receivables resulting from revenue from contracts with customers*
- *Reinsurance recoverables*
- *Receivables from repurchase agreements and securities lending arrangements*
- *Net investments in leases recognized by lessors*
- *Off-balance sheet credit exposures not accounted for as insurance*

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Regulatory update

Current market events

On March 13, 2023, SEC Chair Gary Gensler issued a statement addressing the current market events: "In times of increased volatility and uncertainty, we at the SEC are particularly focused on monitoring for market stability and identifying and prosecuting any form of misconduct that might threaten investors, capital formation, or the markets more broadly. Without speaking to any individual entity or person, we will investigate and bring enforcement actions if we find violations of the federal securities laws."

In the March 15, 2023 SEC open meeting, he also addressed the events of the prior week in the context of enforcement and market stability.

As to enforcement, he noted, "Our staff is particularly focused on identifying and prosecuting any form of misconduct that might threaten investors, capital formation, or the markets more broadly. Without speaking to any individual entity or person, we will investigate and bring enforcement actions if we find violations of the federal securities laws."

As to market stability, he noted, "History is replete with times when tremors starting at one financial institution or corner of the financial system spill out to the broader economy." He then discussed the SEC's focus on resiliency projects, relating to the U.S. Treasury markets, money market funds, open-end funds, private funds, and clearinghouses.

Rules to reduce risks in clearance and settlement

On Feb. 15, 2023, the SEC adopted rule changes to shorten the standard settlement cycle for most broker-dealer transactions in securities from two business days after the trade date (T+2) to one (T+1). The final rule is designed to benefit investors and reduce the credit, market, and liquidity risks in securities transactions faced by market participants.

ACCOUNTING GUIDANCE

- Accounting guidance issued in first quarter 2023
- Accounting guidance effective first quarter 2023: Public companies
- Accounting guidance effective for years ended Dec. 31, 2023: Private companies

REGULATORY UPDATE

- Current market events
- Rules to reduce risks in clearance and settlement
- Updates to compliance and disclosure interpretations
- Non-GAAP financial measures
- Financial Reporting Manual (FRM) updates
- Audit Committee Practices Report: Priorities and committee composition

OTHER DEVELOPMENTS

- Impact of current economic environment

STANDARDS ADOPTION

- Standards issued in 2023
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In addition to shortening the standard settlement cycle, the final rules will improve the processing of institutional trades by requiring a broker-dealer to either enter into written agreements or establish, maintain, and enforce written policies and procedures reasonably designed to ensure the completion of allocations, confirmations, and affirmations as soon as technologically practicable and no later than the end of trade date. The final rules also require registered investment advisers to make and keep records of the allocations, confirmations, and affirmations for certain securities transactions.

Further, the final rules add a new requirement to facilitate straight-through processing, which applies to certain types of clearing agencies that provide central matching services. The final **rules** will become effective 60 days after publication in the Federal Register and the compliance date is May 28, 2024.

Updates to compliance and disclosure interpretations

During the first quarter, SEC Corporate Finance staff updated Compliance and Disclosure Interpretations (C&DI), related to the following:

Regulation S-K Item 402(V) to clarify application of the pay versus performance rules, which require companies to describe the relationship between executive compensation actually paid and the financial performance of a company.

- *128D.01 through 128D.13*
- *228D.01 through 228D.02*

Exchange Act rules for Section 121H. Requirements Under Section 10D: Rule 10D-1 — Listing standards relating to recovery of erroneously awarded compensation:

- *Question 121H.01*
- *Question 121H.02*
- *Question 121H.03*
- *Question 121H.04*

Exchange Act Forms for Section 104; Form 10-K; Section 110; Form 20-F; and Section 112, Form 40-F:

- *Question 104.19*
- *Question 110.08*
- *Question 110.09*
- *Question 112.03*
- *Question 112.04*

Tender offer rules and schedules: See the CD&Is as there were replacements.

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Non-GAAP financial measures

On Dec. 13, 2022, the SEC updated C&DIs related to non-GAAP financial measures through new questions 100.01, 100.04 – 100.06, and 102.10(a)(b)(c). The updates reflect the staff's views that have been communicated in comment letters in recent years and emphasize the staff's position that the determination of whether an adjustment results in a misleading non-GAAP measure depends on a company's individual facts and circumstances.

In January 2023, the Center for Audit Quality (CAQ) issued Alert 2023-01, *Updates to SEC Non-GAAP Financial Measures Compliance and Disclosure Interpretations (C&DIs)*, to provide an overview of the updates as well as a detailed comparison of the previous and new C&DIs.

Financial Reporting Manual (FRM) updates

Recent revisions to the FRM include updating contact information for the staff, as well as financial disclosures about guarantors and issuers of guaranteed securities and affiliates whose securities collateralize a registrant's securities, updates for ASU 2018-12, *Financial Services — Insurance*, and removal of information no longer applicable.

Audit Committee Practices Report: Priorities and committee composition

The Center for Audit Quality (CAQ) announced the second edition of the Audit Committee Practices Report, a collaborative effort between Deloitte's Center for Board Effectiveness and the CAQ. A total of 164 individuals participated in the entire survey from predominantly large U.S.-based public companies. The survey inquired about:

- *Audit committee composition*
- *Areas of oversight*
- *Key risks*
- *Audit committee practices*

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This report provides insight into shifting priorities as well as trends and practices related to audit committee composition. The survey results and related analysis can also serve as a benchmarking resource for gauging an audit committee's development. Many boards are taking a fresh look at their audit committee structures and practices in light of emerging corporate reporting areas and increased risks, according to this report. In addition, cybersecurity; enterprise risk management (ERM); and environmental, social, and governance reporting top many audit committee agendas. The *Audit Committee Practices Report: Priorities and Committee Composition* provides insight into shifting oversight priorities and practices related to audit committee composition. Key insights include:

- *28% of respondents anticipate replacing the current audit committee chair in the next 12 months. A portion of those expecting to change the chair (19%) plan to do so with a current audit committee member and 3% with a current director who is not an audit committee member.*
- *Beyond the chair, an even greater percentage of respondents (42%) anticipate replacing one or more members of the audit committee in the next 12 months. Of these, about 24% expect to do so with current board members, while 18% plan to do so with new directors who are not presently on the board.*
- *74% of respondents don't have a policy (formal or informal) to rotate the chair and/or members of their audit committees, and only 4% require new directors to serve on their audit committees (17% recommend it).*

Outside of financial reporting and internal controls, respondents anticipate cybersecurity (63%); ERM (45%); and environmental, social, and governance disclosure and reporting (39%) as being among their top three areas of focus in the next 12 months.

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Other developments

Impact of current economic environment

Many entities continue to be affected by the current economic environment. In addition to the impact these factors are having on an entity's operations, it's also important to consider the impact on financial reporting.

INFLATION

While inflation has decreased from levels seen in 2022, it remains above the Federal Reserve Bank's target long-term inflation rate. In addition to the impact inflation has on current costs, entities also must take into account expectations of future inflation when they are required to use projected financial information. Those projections will need to take into account estimates of future impacts of inflation on an entity's costs and revenue, which becomes more difficult in period of economic uncertainty. Some common areas where projected financial information is required to be used include:

- *Goodwill impairment*
- *Long-lived asset impairment*
- *Loan or investment impairment*
- *Going-concern assessments*
- *Valuations of assets acquired and liabilities assumed in a business combination or asset acquisition*
- *Fair value measurements of derivatives and other financial instruments*
- *Fair value measurements of share-based payment arrangements*
- *Realizability of deferred tax assets*
- *Other valuations that rely on financial projections*

INTEREST RATES

Many entities have been impacted by the rising interest rates and the resulting increased borrowing costs and interest expense. In addition to these direct impacts, rising interest rates can also impact financial reporting by causing an increase in discount rates, which are a significant input into discounted cash flow models. Common areas where discounted cash flow models can affect financial reporting include:

- *Goodwill impairment*
- *Long-lived asset impairment*
- *Calculation of lease liabilities and right-of-use assets*
- *Valuations of intangible assets*
- *Valuation of share-based payment arrangements*
- *Valuations of investments in debt and equity securities*

OTHER FACTORS

The continued economic uncertainty may also impact entities in other ways, including:

- *Accounting for severance pay and termination benefits if there are layoffs or employee terminations*
- *Potential modifications of share-based payment arrangements*
- *Changes in estimates for contingent consideration*
- *Conclusions on the intent and ability to hold held-to-maturity debt securities until maturity*
- *Conclusions on the intent and ability to hold available-for-sale debt securities in an unrealized loss position until they recover in value*

Standards adoption

Standards issued in 2023

Final ASU	Early adoption	Effective date
ASU 2023-02: *Investments — Equity Method and Joint Ventures (Topic 323) — Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method*	Yes	**Public:** Fiscal years beginning after Dec. 15, 2023, and interim periods within those fiscal years. **Nonpublic:** Fiscal years beginning after Dec. 15, 2024, and interim periods within those fiscal years.
ASU 2023-01: *Leases (Topic 842): Common Control Arrangements*	Yes	Effective for all entities for fiscal years beginning after Dec. 15, 2023, and interim periods within those fiscal years

**Effective 2023 for nonpublic companies*
***Effective 2023 for public business entities*

Standards issued in prior years effective 2023 or after

Final ASU	Early adoption	Effective date
ASU 2022-06: *Reference Rate Reform (Topic 848) — Deferral of the Sunset Date of Topic 848*	N/A	Effective upon issuance. Sunset date of Topic 848 is extended to Dec. 31, 2024.*,**
ASU 2022-05: *Financial Services — Insurance (Topic 944) — Transition for Sold Contracts*	Yes	**SEC registrants (excluding entities that qualify as SRCs):** Fiscal years beginning after Dec. 15, 2022, including interim periods within those fiscal years.** **All other entities:** Fiscal years beginning after Dec. 15, 2024, and interim periods beginning in fiscal years beginning after Dece.15, 2025.
ASU 2022-04: *Liabilities — Supplier Finance Programs (Subtopic 405-50) — Disclosures of Supplier Finance Program Obligations*	Yes	Effective for all entities for fiscal years beginning after Dec. 15, 2022.*,**
ASU 2022-03: *Fair Value Measurements (Topic 820) — Fair Value Measurement of Equity Securities Subject to Contractual Sales Restrictions*	Yes	**Public:** *Fiscal years beginning after Dec. 15, 2023, and interim periods within those fiscal years.* **Nonpublic:** *Fiscal years beginning after Dec. 15, 2024, and interim periods within those fiscal years.*
ASU 2022-02: *Financial Instruments — Credit Losses (Topic 326) — Troubled Debt Restructurings and Vintage Disclosures*	Yes	**SEC registrants (excluding entities that qualify as SRCs):** Fiscal years beginning after Dec. 15, 2022, including interim periods within those fiscal years.** **All other entities:** Upon adoption of ASU 2016-13.*
ASU 2022-01: *Derivatives and Hedging (Topic 815) — Fair Value Hedging — Portfolio Layer Method*	Yes	**Public:** Fiscal years beginning after Dec. 15, 2022, and interim periods within those fiscal years.** **Nonpublic:** Fiscal years beginning after Dec. 15, 2023, and interim periods within those fiscal years.
ASU 2021-08: *Business Combinations (Topic 805) — Accounting for Contract Assets and Contract Liabilities from Contracts with Customers*	Yes	**Public:** Fiscal years beginning after Dec. 15, 2022, and interim periods within those fiscal years.** **Nonpublic:** Fiscal years beginning after Dec. 15, 2023, and interim periods with-in those fiscal years.
Update 2020-11: *Financial Services — Insurance (Topic 944): Effective Date and Early Adoption*	Yes	**SEC registrants (excluding entities that qualify as SRCs):** *Fiscal years beginning after Dec. 15, 2022, including interim periods within those fiscal years.*** **All other entities:** *Fiscal years beginning after Dec. 15, 2024, and interim periods beginning in fiscal years beginning after Dec. 15, 2025.*

**Effective 2023 for nonpublic companies*
***Effective 2023 for public business entities*

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Final ASU	Early adoption	Effective date
Update 2020-06: *Debt — Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging — Contracts in Entity's Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity's Own Equity*	Yes — but no earlier than fiscal years beginning after Dec. 15, 2020	**SEC registrants (excluding entities eligible to be SRCs):** *Fiscal years beginning after Dec. 15, 2021, and interim periods within those fiscal years.* **All other entities:** *Fiscal years beginning after Dec. 15, 2023, and interim periods within those fiscal years.*
Update 2020-03: *Codification Improvements to Financial Instruments*	Yes	*See ASU**
Update 2020-02: *Financial Instruments — Credit Losses (Topic 326) and Leases (Topic 842): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 119 and Update to SEC Section on Effective Date Related to Accounting Standards Update No. 2016-02, Leases (Topic 842)*	Yes, if ASU 2016-13 adopted	*See ASU 2016-13**
Update 2019-04: *Codification Improvements to Topic 326, Financial Instruments — Credit Losses, Topic 815 Derivatives and Hedging, and Topic 825, Financial Instruments*	Yes	*See ASU*
Update 2018-19: *Codification Improvements to Topic 326, Financial Instruments — Credit Losses*	Yes, if ASU 2016-13 adopted	*See ASU 2016-13**
Update 2018-12: *Financial Services — Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts*	Yes	**SEC registrants (excluding entities eligible to be SRCs):** *Fiscal years beginning after Dec. 15, 2022, and interim periods within those fiscal years.*** **All other entities:** *Fiscal years beginning after Dec. 15, 2024, and interim periods beginning after Dec. 15, 2025.*
Update 2016-13: *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*	Yes, as of fiscal years beginning after Dec. 15, 2018, including interim periods within those fiscal years	**SEC registrants (excluding entities that qualify as SRCs):** *Fiscal years beginning after Dec. 15, 2019, including interim periods within those fiscal years.* **All other entities:** *Fiscal years beginning after Dec. 15, 2022, including interim periods within those fiscal years.**

**Effective 2023 for nonpublic companies*
***Effective 2023 for public business entities*