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Accounting, financial reporting, and regulatory developments

SECOND QUARTER 2021

In this update, we highlight some of the more important 2021 second quarter accounting, financial reporting, and regulatory developments that may impact both public and private companies. The content is not meant to be all-inclusive.

Accounting guidance

Accounting guidance issued in second quarter 2021

ASU 2021-04, Earnings Per Share (Topic 260), Debt – Modifications and Extinguishments (Subtopic 470-50), Compensation – Stock Compensation (Topic 718), and Derivatives and Hedging – Contracts in Entity's Own Equity (Subtopic 815-40): Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options, is intended to reduce diversity in accounting for modifications or exchanges of freestanding equity-classified written call options, that remain equity-classified after the modification or exchange. The new ASU provides a framework to measure the impact of the modification or exchange and requires the effect of a modification or an exchange be recognized in the same manner as if cash had been paid as consideration for the transaction. The new guidance is effective for reporting periods beginning after Dec. 15, 2021, and should be applied prospectively to modifications or exchanges occurring on or after the effective date of the amendments. Early adoption is permitted.

Lease accounting: The time is now

In 2020, the FASB approved the deferral of the effective date for ASC 842 to Jan. 1, 2022, for calendar year-end nonpublic entities. While many entities have taken advantage of the deferral, those that have already adopted ASC 842 consistently indicate the implementation process was more time-consuming than initially anticipated. Much of the implementation process and lease contract analysis is manual in nature and can place constraints on the organization's resources. The following actions should be taken now to avoid a potential rush to the deadline:

- **Forming an implementation team:** The first step that organizations should make in planning for the implementation of the new lease standard is to form an implementation team. While the implementation team

is for a new accounting standard, many organizations have found it necessary to include resources outside of the accounting/finance department on the implementation team. For example, many entities have included members of the operations or legal departments as those departments are often involved in the negotiation of lease contracts. For entities with larger populations of leases, the IT department is often included to assist in determining the appropriate technology solution.

- **Identification of leases:** Once the implementation team has been formed, entities should compile an inventory of all lease contracts. In organizations with few lease agreements and centralized processes for approving leases, this exercise may be relatively straightforward. However, in many organizations, multiple locations exist and decision-making over leasing arrangements is decentralized. In these instances, the implementation team may find that identifying the total population of leases is more time-consuming than initially planned. While accounting departments are aware of the most significant leases, there may be leases that are individually insignificant but, in aggregate, become significant. In addition, entities must evaluate other types of contacts (such as supplier contracts) to determine if those contracts include any embedded leases. An example of an embedded lease would be a supplier contract where the supplier provides specialized goods and provides equipment needed to use those goods. Identifying the total population of leases early in the process is critical for successful implementation of ASC 842.
- **Assess technology needs:** The new lease standard will require all leases to be recorded on the balance sheet. Organizations will need to assess how they will track and account for their leases. Options for tracking include use of spreadsheets, standalone lease software, and a lease accounting module for their enterprise resource planning (ERP) system. Each option has its advantages and disadvantages, and entities should evaluate which option best fits their needs based on the complexity of their lease population. Consideration should be given to the number of leases and complexity of the lease arrangements. Entities should consider the technology solution they plan on using early in the process as the implementation process is more efficient when the technology solution has been implemented before an entity starts to review lease contracts.
- **Debt covenant considerations:** While the impacts on covenants based on overall assets and liabilities are easily understood, some covenants may be based on debt service ratios or amount of debt outstanding. For these ratios, depending on how the covenant is written, payments on leases that are recorded on the balance sheet or the amount of the lease liability may impact these calculations. Affected entities should discuss covenant calculations with their lender prior to the adoption of the new standard if there is uncertainty as to how the new lease standard will impact the calculation. Entities and lenders may elect to amend covenants prior to the implementation of the lease standard to avoid potential covenant compliance issues.

- Sale-leaseback transactions: When the new lease standard becomes effective, there will no longer be deferred gains on prior sale-leaseback transactions. Upon transition, the prior deferred gain will be derecognized and recorded as an adjustment to equity in most situations. As a result, the portion of the gain that was deferred will not be recorded through income. Entities with significant deferred gains from sale-leaseback transactions should discuss this issue in advance in order to understand the significant change in the accounting for deferred gains upon adoption as it may impact budgets and projections if projections include future income related to those deferred gains.

FASB evaluating accounting for goodwill

An ongoing project on the FASB's technical agenda is a review of the subsequent accounting for goodwill for both public business entities, private companies, and not-for-profit entities. As part of this project, the FASB is evaluating whether to retain the existing impairment model for accounting for goodwill, modify the impairment model, or move to an amortization method to account for goodwill. The project is still in the early stages; however, tentative decisions made to date can be found on the project page on the FASB's website.

Regulatory update

Special purpose acquisition companies

The increase in special purpose acquisition companies (SPACs) and the related acquisition transactions has continued to attract attention from regulators. SPACs have recently increased in popularity as they provide quick access to the capital markets. The use of SPACs raises complex financial reporting and governance considerations.

As we discussed in the prior quarter update, the SEC issued reminders of existing rules and their concerns on SPAC acquisition targets not being ready to be issuers following the SPAC acquisition transaction. The SEC reminded boards of directors, audit committees, management, and auditors of operating companies involved in a merger with a SPAC to fulfill their professional responsibilities so that companies meet their obligations under the federal securities laws and investors are provided with high-quality financial reporting at the time of the merger and on an ongoing basis.

CENTER FOR AUDIT QUALITY (CAQ) ALERT ON SPACS

In May 2021, the CAQ issued Alert 2021-01, Auditor and Audit Committee Considerations Relating to SPAC Initial Public Offerings and Mergers, which provides a good summary of the various phases of a SPAC transaction along with specific considerations auditors, audit committees, and management of private companies preparing to go public through a SPAC should consider prior to and during the transaction.

Management and audit committees of private companies determining whether to "go public" via a SPAC transaction should consider the following (not all-inclusive):

- **Public company readiness**
- **SPAC sponsor experience**
- **Corporate governance**
- **Accounting, reporting, and disclosure issues**
- **External auditor selection and oversight**

SEC STATEMENT ON SPAC WARRANTS

In April 2021, John Coates, acting director of the SEC's Division of Corporation Finance, and Paul Munter, acting chief accountant, said in a statement that certain warrants issued by a SPAC should be classified as liabilities rather than equity. The statement was based on their evaluation of the fact patterns relating to the accounting for warrants issued in connection with a SPAC's formation and initial registered offering. They noted that while the specific terms of these warrants can vary, certain features of warrants issued in SPAC transactions may be common across many entities. The statement was issued to highlight the potential accounting implications of certain terms that may be common in warrants included in SPAC transactions. Warrants classified as liabilities rather than equity must be measured at fair value, with changes in fair value included in net income each period. The statement also discussed the financial reporting considerations that apply if a registrant and its auditors determine there is a material error in any previously filed financial statements.

This statement has resulted in many restatements as well as some companies choosing to modify their warrants prior to the SPAC IPO process. We suggest that management carefully consider the statement and the potential implications when determining the accounting treatment for warrants issued in a SPAC transaction.

CLIMATE AND ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) DISCLOSURES

In March 2021, the SEC announced the creation of a Climate and ESG Task Force in the Division of Enforcement. The initial focus of the task force will be to identify any material gaps or misstatements in issuers' disclosures of climate risks under existing rules. The task force will also analyze disclosure and compliance issues relating to investment advisors' and funds' ESG strategies and work closely with other SEC divisions and offices, including the Divisions of Corporation Finance, Investment Management, and Examinations.

In June 2021, the SEC's new chair, Gary Gensler, commented that he has asked SEC staff to put together recommendations on mandatory company disclosures on climate risk and human capital. He indicated that the SEC may require public companies to publish data on a whole range of new areas, including greenhouse gas emissions, workforce turnover, and diversity.

Human capital disclosures will build on prior SEC disclosure updates and could include a number of metrics, such as workforce turnover, skills and development training, compensation, benefits, workforce demographics including diversity, and health and safety.

In May 2021, SEC Commissioner Allison Herren Lee delivered keynote remarks at the 2021 ESG Disclosure Priorities Event hosted jointly by the CAQ, AICPA, the Chartered Institute of Management Accountants, and the Sustainability Accounting Standards Board (SASB). She urged attendees to submit comments to the SEC as it plans new ESG disclosure rules and also addressed what she believes are four myths and misconceptions related to materiality as it pertains to climate and ESG disclosures. They are summarized as follows:

- **Myth #1:** *ESG matters (indeed all matters) material to investors already are required to be disclosed under the securities laws. She believes that this is a myth and stated that climate and ESG information important to a reasonable investor isn't necessarily required to be disclosed simply because it is material.*
- **Myth #2:** *Where there is a duty to disclose climate and ESG matters, we can rest assured that such disclosures are being made. In contrast to this myth, she believes that a disclosure system that lacks sufficient specificity and relies too heavily on a broad-based concept of materiality will fall short of eliciting information material to reasonable investors.*

- **Myth #3:** *SEC disclosure requirements must be strictly limited to material information. In contrast to this myth, she believes that the idea that the SEC must establish the materiality of each specific piece of information required to be disclosed in SEC rules is legally incorrect, historically unsupported, and inconsistent with the needs of modern investors, especially when it comes to climate and ESG.*
- **Myth #4:** *Climate and ESG are matters of social or "political" concern and not material to investment or voting decisions. She believes that this is a myth and stated that the SEC is increasingly seeing all manner of market participants embrace ESG factors as significant drivers of decision-making, risk assessment, and capital allocation precisely because of their relationship to firm value.*

Other developments

Accounting considerations related to government assistance received

In response to the COVID-19 pandemic, the federal government provided assistance to entities through a number of new programs. For entities that received funding through these programs, it's important to consider the accounting implications related to those programs. Some of the most common programs include:

- *Paycheck Protection Program (PPP) Loan Program — one of the most commonly used government assistance programs to help entities during the pandemic has been the PPP Loan Program. As these loans are eligible for forgiveness if certain criteria are met, they introduced a number of unique accounting challenges to entities. See our article, Paycheck Protection Program loans accounting: What are the options?, for additional information on the accounting for PPP loans.*
- *Provider Relief Funds (PRF) — The U.S. Department of Health and Human Services (HHS), established PRF to distribute $178 billion of funds to hospitals and healthcare providers to combat the COVID-19 pandemic. Receipt of funding will likely result in* ***additional audit requirements*** *for both public and nonpublic entities. To learn more about the additional audit requirements, please refer to the following articles:*
  - *OMB releases the Compliance Supplement Addendum*
  - *HHS issues long-awaited revised PRF guidance*

Standards adoption

Standards issued in 2021

Final ASU	Early adoption	Effective date
ASU 2021-04: *Earnings Per Share (Topic 260), Debt – Modifications and Extinguishments (Subtopic 470-50), Compensation – Stock Compensation (Topic 718), and Derivatives and Hedging – Contracts in Entity's Own Equity (Subtopic 815-40): Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options*	Yes	**Effective for all entities for fiscal years beginning after Dec. 15, 2021**
ASU 2021-03: Intangibles – *Goodwill and Other (Topic 350): Accounting Alternative for Evaluating Triggering Events*	Yes	**Nonpublic:** *fiscal years beginning after Dec. 15, 2019.** **Public business entities:** *Not eligible*
ASU 2021-02: Franchisors – *Revenue from Contracts with Customers (Subtopic 952-606): Practical Expedient*	Yes	**Nonpublic:** *If ASC 606 has not already been adopted, annual reporting periods beginning after Dec. 15, 2019, and interim periods within annual periods beginning after Dec. 15, 2020.** *If ASC 606 has already been adopted, interim and annual reporting periods beginning after Dec. 15, 2020.** **Public business entities:** *Not eligible*
ASU 2021-01: *Reference Rate Reform (Topic 848): Scope*	Effective upon issuance	*Effective for the period March 12, 2020 through Dec. 31, 2022. *, ***

**Effective 2021 for nonpublic companies*
***Effective 2021 for public business entities*

Standards issued in prior years effective 2021 or after

Final ASU	Early adoption	Effective date
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 December 15, 2025.*
Update 2020-10: *Codification Improvements*	Yes	**See ASU**
Update 2020-08: *Codification Improvements to Subtopic 310-20, Receivables – Non-refundable Fees and Costs*	Yes for nonpublic entities only — but no earlier than years beginning after Dec. 15, 2020	**Nonpublic:** *fiscal years beginning after Dec. 15, 2021, and interim periods within annual periods beginning after Dec. 15, 2022.* **Public business entities:** *fiscal years beginning after Dec. 15, 2020, and interim periods within these fiscal years. ***
Update 2020-07: *Not-for-Profit Entities (Topic 958): Presentation and Disclosures by Not-for-Profit Entities for Contributed Nonfinancial Assets*	Yes	*Effective for annual periods beginning after June 15, 2021, and interim periods within annual periods beginning after June 15, 2022.*
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 2020-05: *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Date for Certain Entities*	Yes	**Revenue Recognition** **Nonpublic:** *fiscal years beginning after Dec. 15, 2019, and interim periods within annual periods beginning after Dec. 15, 2020** **Leases** **Nonpublic:** *fiscal years beginning after Dec. 15, 2021, and interim periods within annual periods beginning after Dec. 15, 2022* **Public not-for-profit entities:** *fiscal years beginning after Dec. 15, 2019 and interim periods within those fiscal years*

**Effective 2021 for nonpublic companies*
***Effective 2021 for public business entities*

Update 2020-04: *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*	Effective upon issuance	*Effective for the period March 12, 2020 through December 31, 2022 *, ***
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 2020-01: *Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815): Clarifying the Interactions between Topic 321, Topic 323, and Topic 815*	Yes	**Nonpublic:** *fiscal years beginning after December 15, 2021, and interim periods within those fiscal years.* **Public business entities:** *fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. ***
Update 2019-12: *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*	Yes	**Nonpublic:** *fiscal years beginning after Dec. 15, 2021 and interim periods within annual periods beginning after Dec. 15, 2022.* **Public business entities:** *fiscal years beginning after Dec. 15, 2020, and interim periods within these fiscal years. ***
Update 2019-11: *Codification Improvements to Topic 326, Financial Instruments – Credit Losses*	Yes, if ASU 2016-13 adopted	*See ASU 2016-13*
Update 2019-10: *Financial Instruments – Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*	N/A	*See ASU 2016-02* *See ASU 2016-13* *See ASU 2017-12*
Update 2019-09: *Financial Services – Insurance (Topic 944): Effective Date*	N/A	*See ASU 2018-12*
Update 2019-05: *Financial Instruments – Credit Losses (Topic 326): Targeted Transition Relief*	Yes, if ASU 2016-13 adopted	*See ASU 2016-13*

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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 2019-02: *Entertainment – Films – Other Assets – Film Costs (Subtopic 926-20) and Entertainment Broadcasters – Intangible – Goodwill and Other (Subtopic 920-350): Improvements to Accounting for Costs of Films and License Agreements for Program Materials*	Yes	**Nonpublic:** *fiscal years beginning after Dec. 15, 2020. **
Update 2019-01: *Leases (Topic 842): Codification Improvements*	Yes, if ASU 2016-02 adopted	*See ASU 2016-02*
Update 2018-20: *Leases (Topic 842): Narrow-Scope Improvements for Lessors*	Yes, if ASU 2016-02 adopted	*See ASU 2016-02*
Update 2018-19: *Codification Improvements to Topic 326, Financial Instruments – Credit Losses*	Yes, if ASU 2016-13 adopted	*See ASU 2016-13*
Update 2018-18: *Collaborative Arrangements (Topic 808): Clarifying the Interaction between Topic 808 and Topic 606*	Yes, if ASU 2014-09 adopted	**Nonpublic:** *annual reporting periods beginning after Dec. 15, 2020, and interim periods within annual periods beginning after Dec. 15, 2021. ** **Public business entities:** *fiscal years beginning after Dec. 15, 2019, and interim periods within these fiscal years.*
Update 2018-17: *Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities*	Yes	**Nonpublic:** *fiscal years beginning after Dec. 15, 2020, and interim periods beginning after Dec. 15, 2021. ** **Public business entities:** *fiscal years beginning after Dec. 15, 2019, and interim periods within these fiscal years.*
Update 2018-16: *Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes*	Yes, if ASU 2017-12 adopted	*See ASU 2017-12 **

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**Effective 2021 for public business entities

Update 2018-15: *Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*	Yes	**Nonpublic:** *annual reporting periods beginning after Dec. 15, 2020, and interim periods within annual periods beginning after Dec. 15, 2021. ** **Public business entities:** *fiscal years beginning after Dec. 15, 2019, and interim periods within those fiscal years.*
Update 2018-14: *Compensation – Retirement Benefits – Defined Benefit Plans – General (Subtopic 715-20): Disclosure Framework – Changes to the Disclosure Requirements for Defined Benefit Plans*	Yes	**Nonpublic:** *fiscal years ending after Dec. 15, 2021. ** **Public business entities:** *fiscal years ending after Dec. 15, 2020.*
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, 2021 and interim periods within those fiscal years.* **All other Entities:** *fiscal years beginning after Dec. 15, 2023 and interim periods beginning after Dec. 15, 2024.*
Update 2018-11: *Leases (Topic 842): Targeted Improvements*	Yes, if ASU 2016-02 adopted	*See ASU 2016-02*
Update 2018-10: *Codification Improvements to Topic 842, Leases*	Yes, if ASU 2016-02 adopted	*See ASU 2016-02*
Update 2018-01: *Leases (Topic 842) – Land Easement Practical Expedient for Transition to Topic 842*	Yes	*See ASU 2016-02*
Update 2017-12: *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*	Yes	**Nonpublic:** *fiscal years beginning after Dec. 15, 2020 and interim periods beginning after Dec. 15, 2021. ** **Public business entities:** *fiscal years beginning after Dec. 15, 2018 and interim periods within those fiscal years.*

*Effective 2021 for nonpublic companies
**Effective 2021 for public business entities

Update 2017-04: *Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*	Yes	**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.*
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.*
Update 2016-02: *Leases (Topic 842)*	Yes	**Nonpublic:** *fiscal years beginning after Dec. 15, 2021, and interim periods within annual periods beginning after Dec. 15, 2022* **Public not-for-profit entities:** *fiscal years beginning after Dec. 15, 2019 and interim periods within those fiscal years* **Public business entities:** *fiscal years beginning after Dec. 15, 2018, including interim periods within those fiscal years.*

*Effective 2021 for nonpublic companies
**Effective 2021 for public business entities