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Accounting, financial reporting, and regulatory developments

THIRD QUARTER 2021

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

VIEW THE DOCUMENT

Accounting guidance

Accounting guidance issued in third quarter 2021

ASU 2021-06: Presentation of Financial Statements (Topic 205), Financial Services — Depository and Lending (Topic 942), and Financial Services — Investment Companies (Topic 946), Amendments to SEC Paragraphs Pursuant to SEC Final Rule Releases No. 33-10786, Amendments to Financial Disclosures about Acquired and Disposed Businesses, and No. 33-10835, Update of Statistical Disclosures for Bank and Savings and Loan Registrants, aligns the guidance in the SEC paragraphs in the Accounting Standards Codification with the final rule No. 33-10786 and final rule No. 33-10835 that were issued by the SEC.

ASU 2021-05: Leases (Topic 842) — Lessors — Certain Leases with Variable Payments, was issued to address stakeholder concerns around sales-type and direct financing leases with significant variable lease payments that do not depend on a reference index or rate. ASC Topic 842 requires variable payments that do not depend on a reference index or rate to be excluded from the initial calculation of the lease receivable, which can result in an entity recognizing a selling loss at lease commencement even if the lessor expects the arrangement to be profitable overall. To address this, ASU 2021-05 requires lessors to classify a lease with variable lease payments that do not depend on a reference index or rate as an operating lease if both of the following criteria are met:

- *The lease would be classified as a sales-type lease or a direct financing lease in accordance with the classification requirements in ASC 842-10-25.*
- *The lessor would have otherwise recognized a day-one loss.*

ASU 2021-05 will be effective for fiscal years beginning after Dec. 15, 2021; however, early adoption is permitted. Entities that have not yet adopted ASC Topic 842, will apply the amendments following the transition method selected for ASC Topic 842. Entities that have already adopted ASC Topic 842 have the option to either adopt these amendments prospectively to new leases that are entered into on or after the date the entity first applies this guidance or retrospectively to the date that ASC Topic 842 was adopted.

FASB evaluating accounting for revenue contracts acquired in a business combination

The FASB's technical agenda includes a project to review the accounting for revenue contracts acquired in a business combination. Since the adoption of ASC Topic 606, diversity in practice has developed around the accounting for contract assets and contract liabilities acquired in a business combination. Based on feedback received on the exposure draft, the FASB's tentative decisions have indicated support for accounting for contract assets and liabilities from acquired revenue contracts in accordance with ASC 606 at the acquisition date rather than at fair value. The project is expected to be finalized in the fourth quarter of 2021, and tentative decisions made to date can be found on the **project page on the FASB's website**.

Regulatory update

Climate and environmental, social and governance (ESG) disclosures

As discussed in previous newsletters, disclosures related to climate risks and human capital matters are a focus of the SEC.

SEC CHAIR GENSLER DISCUSSES CLIMATE RISK DISCLOSURES

In July 2021, SEC Chair Gary Gensler discussed the SEC's role in **climate risk disclosures**. In 2010, the SEC offered guidance on climate risk disclosure; however, a lot has changed since then, and investors do not have the ability to compare company disclosures to the degree that they need. He indicated that investors are looking for consistent, comparable, and decision-useful disclosures so they can put their money in companies that fit their needs. He also noted that there were more than 550 unique comment letters submitted in response to Commissioner Allison Herren Lee's statement on climate disclosures in March 2021 and that three out of every four of these responses support mandatory climate disclosure rules.

As a result, Chair Gensler has asked the SEC staff to develop a mandatory climate risk disclosure rule proposal for the SEC's consideration by the end of 2021. He said that he believes the SEC can bring greater clarity to climate risk disclosures. He has asked staff to consider whether these disclosures should be filed in the Form 10-K, living alongside other information that investors use to make their investment decisions.

These disclosures should be consistent and comparable. The consistency with which issuers report information leads to comparability between companies, today and over time. He also noted that they should be mandatory because investors can benefit from that consistency and comparability. When disclosures remain voluntary, it can lead to a wide range of inconsistent disclosures. He also noted that these disclosures should be "decision-useful."

A decision-useful disclosure has sufficient detail so investors can gain helpful information and is not simply generic text. In appropriate circumstances, he believes such prescribed disclosure strengthens comparability. Chair Gensler has asked the staff to consider a variety of qualitative and quantitative information about climate risk that investors either currently rely on or believe would help them make investment decisions going forward.

SAMPLE LETTER TO COMPANIES REGARDING CLIMATE CHANGE DISCLOSURES

In September 2021, the Division of Corporation Finance posted a **sample letter** to companies regarding climate change disclosures. The illustrative letter includes sample comments it may issue to companies regarding their climate-related disclosure or the absence of such disclosure. The sample comments do not constitute an exhaustive list of the issues that companies should consider.

A number of existing SEC rules may require disclosure related to climate change. For example, and depending on the particular facts and circumstances, information related to climate change-related risks and opportunities may be required in disclosures related to a company's description of business, legal proceedings, risk factors, and management's discussion and analysis of financial condition and results of operations. Disclosure matters discussed in the 2**010 Climate Change Guidance** include the following:

- *The impact of pending or existing climate-change related legislation, regulations, and international accords*
- *The indirect consequences of regulation or business trends*
- *The physical impacts of climate change*

Companies must also disclose, in addition to the information expressly required by SEC regulation, "such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading."

We recommend that management and audit committees review this sample letter in connection with company disclosures in upcoming filings.

CENTER FOR AUDIT QUALITY (CAQ): S&P 500 AND ESG REPORTING

In August 2021, the CAQ posted a summary and analysis of the most recent publicly available ESG data for S&P 500 companies. The information the CAQ examined was primarily outside of an SEC submission in a standalone ESG, sustainability, corporate responsibility, or similar report. The CAQ found that the timing and frequency at which companies report ESG information varies. As of June 18, 2021, roughly 54% of S&P 500 companies had published ESG data for periods ending in 2020. About 37% of S&P 500 companies published ESG data for periods ending in 2019.

CAQ WHITE PAPER ON AUDITED FINANCIAL STATEMENTS AND CLIMATE-RELATED RISK CONSIDERATIONS

In September 2021, the CAQ issued a white paper, ***Audited Financial Statements and Climate-Related Risk Considerations***, that provides investors and other stakeholders with a foundational understanding of current climate-related reporting and auditing requirements in the United States and how they are applied. The CAQ released this report at a pivotal moment for climate-related and other ESG reporting, as investor and other stakeholder demand for this information continues to increase.

Currently, climate-related risks are considered and assessed by management and auditors during the preparation and auditing of financial statements. Under current U.S. accounting rules, climate-related risks may have a direct impact on the financial statements, an indirect impact, or in some cases no impact at all. Understanding current financial statement requirements can be a useful starting point for investors and others as they consider how and where to obtain their desired climate-related information to make capital allocation decisions and bridge any information gap that may exist today ahead of future rulemaking by the SEC or others.

Management is responsible for preparing the financial statements of the entity in accordance with U.S. GAAP, including assessing whether they reflect all required disclosures, including climate- related, if applicable. Although U.S. GAAP today does not include explicit references to climate-related risks, companies are required to consider such risks when the effect could reasonably be material to the financial statements. The financial reporting requirements for climate-related risks will vary from company to company and depend on several factors, including the nature of the company's business, its industry, geographic footprint, types of underlying transactions, and the significance of the climate- related risk to the entity's business, among others.

ACCOUNTING GUIDANCE

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STANDARDS ADOPTION

Forward-looking climate-related risks that could potentially impact an entity's financial statements typically fall into one of the following categories:

1. *Physical risks (e.g., the risk that an entity's facilities will be damaged by a severe weather event or that a company will need to relocate its facilities away from low-lying coastal areas).*
2. *Risks associated with the transition to a low-carbon economy (e.g., regulatory risk associated with required changes to a company's business and/or the impact of a company's net-zero commitments on management's evaluation of impairment or the useful lives of assets).*

The CAQ acknowledges that the time horizon for which climate-related risks come to fruition also will vary by company and industry; therefore, while risks may exist, the impact on the current-period financial statements may not be material.

The CAQ noted that it has observed a growing trend in companies making commitments to be carbon neutral or carbon negative by a specified date in the future. This trend seems to span across many industries, from energy companies that historically relied on fossil fuels committing to substantially reduce their carbon emissions, to automotive manufacturing entities committing to phase out production of traditional vehicles that are powered by fossil fuels. The impact of such commitments on a given company's financial statements and audit will vary depending on a number of factors, including actions management has taken or plans to take to achieve those commitments; the timing of those actions; and the costs associated with them. The white paper includes several examples to consider.

Crypto assets market

In September 2021, SEC Chair Gary Gensler testified before the U.S. Senate Committee on Banking, Housing, and Urban Affairs where he discussed several topics, including the crypto assets market. Chair Gensler called the current state of crypto investing something "akin to the Wild West" and called for greater investor protections. He stated that there is not enough investor protection in crypto finance, issuance, trading, or lending. Chair Gensler has asked the SEC staff to consider how the SEC can work with other financial regulators under current authorities to best bring investor protection to these markets and to consider what gaps, with Congress's assistance, the SEC may be able to fill. He called on Congress to act on crypto legislation.

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Board diversity

In August 2021, the SEC approved Nasdaq's proposed rule changes requiring issuers to disclose certain information about the diversity of the company's board and to offer certain companies access to a complimentary board recruiting service. These rules will allow investors to gain a better understanding of Nasdaq-listed companies' approach to board diversity, while also ensuring that those companies have the flexibility to make decisions that best serve their shareholders.

As the SEC order discusses, the rules are consistent with the requirements of the Exchange Act and reflect calls from investors for greater transparency about the people who lead public companies. It was also noted that a broad cross-section of commenters supported the proposed board diversity disclosure rule.

The Nasdaq rule changes require companies to have at least two diverse directors on their boards or explain why they are not in compliance. Listed companies will be given one year of complimentary access to a board recruiting service to help identify diverse candidates.

Standards adoption

Standards issued in 2021

Final ASU	Early adoption	Effective date
ASU 2021-06: *Presentation of Financial Statements (Topic 205), Financial Services — Depository and Lending (Topic 942), and Financial Services — Investment Companies (Topic 946), Amendments to SEC Paragraphs Pursuant to SEC Final Rule Releases No. 33-10786, Amendments to Financial Disclosures about Acquired and Disposed Businesses, and No. 33-10835, Update of Statistical Disclosures for Bank and Savings and Loan Registrants*	N/A	**Effective upon issuance**
ASU 2021-05: *Leases (Topic 842) — Lessors — Certain Leases with Variable Payments*	Yes	**Nonpublic:** *fiscal years beginning after Dec. 15, 2021, and interim periods within fiscal years beginning after Dec. 15, 2022* **Public:** *fiscal years beginning after Dec. 15, 2021, and interim periods within those fiscal years*
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 Dec. 15, 2025.*
Update 2020-10: *Codification Improvements*	Yes	**See ASU**
Update 2020-08: *Codification Improvements to Subtopic 310-20, Receivables — Nonrefundable 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*
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 Dec. 31, 2022*,***
Update 2020-03: *Codification Improvements to Financial Instruments*	Yes	*See ASU*

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

Final ASU	Early adoption	Effective date
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 2016-02* *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 Dec. 15, 2021, and interim periods within those fiscal years.* **Public business entities:** *fiscal years beginning after Dec. 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*
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.** **Public business entities:** *fiscal years beginning after Dec. 15, 2019.*
Update 2019-01: *Leases (Topic 842): Codification Improvements*	Yes, if ASU 2016-02 adopted	*See ASU 2016-02*

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

Final ASU	Early adoption	Effective date
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**
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*

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

Final ASU	Early adoption	Effective date
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.*
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*