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# Financial reporting briefs

## What you need to know about this quarter's accounting, financial reporting and other developments

March 2024

Building a better working world

# Top story

*Welcome to the March 2024* Financial reporting briefs. *This edition highlights the latest developments in financial reporting and alerts you to some important considerations for 2024.*

*Interested in the SEC's final rules on climate-related disclosures? We've got it covered in our* Top Story.

*In our* Accounting update *section, we discuss the FASB's proposal that would clarify the accounting for induced conversions of convertible debt instruments and reminders on estimating the annual effective tax rate in interim periods.*

*In our* Regulatory developments *section, we provide updates on SEC and other developments.*

***Need more information?*** *Check out our* Reference library, *where we list our recent publications on the topics discussed here and provide links to them.*

## SEC adopts rules requiring climate-related disclosure for registrants

The Securities and Exchange Commission (SEC) adopted final rules that will require registrants to disclose climate-related information in registration statements and annual reports, including material climate-related risks, descriptions of board oversight and risk management activities, the material impacts of these risks on a registrant's strategy, business model and outlook, and any material climate-related targets or goals.

The landmark rules also will require accelerated and large accelerated filers to disclose gross direct greenhouse gas (GHG) emissions from operations they own or control (Scope 1 emissions) and/or indirect emissions from purchased electricity and other forms of energy their operations consume (Scope 2 emissions), if material. These disclosures will be subject to independent third-party assurance. Nonaccelerated filers, emerging growth companies and smaller reporting companies will be exempt from the requirements to disclose Scope 1 and Scope 2 emissions. Registrants will also have to disclose, among other things, certain effects of severe weather events and other natural conditions and amounts related to carbon offsets and renewable energy credits or certificates in their audited financial statements.

In a shift from the proposal, the rules will not require registrants to disclose indirect GHG emissions from upstream and downstream activities (Scope 3 emissions). They also further incorporate the US Supreme Court's definition of materiality and give companies more time to comply. Some of the requirements, such as those related to organizational boundaries, are better aligned with those required or allowed by other reporting regulations and standards (e.g., the European Union's Corporate Sustainability Reporting Directive (CSRD), California's climate disclosure laws, the International Sustainability Standards Board's standards). However, significant differences remain, such as the absence of a requirement to report Scope 3 emissions.

The rules will require registrants to disclose whether any climate-related risks have had or are reasonably likely to have a material impact on their strategy, results of operations or financial condition. Registrants will have to describe the actual and potential material impacts of each disclosed climate-related risk on their strategy, business model and outlook, and how they are considered as part of their strategy, financial planning and capital allocation.

Registrants will need to provide a quantitative and qualitative description of material expenditures and material impacts on financial estimates and assumptions resulting directly from activities to mitigate climate-related risks, among other activities. Registrants will also be required to disclose any climate-related targets or goals that have materially affected or are reasonably likely to materially affect their business, results of operations or financial condition. Disclosure of a target or goal won't depend on whether it has been publicly announced, so registrants will need to include nonpublic targets and goals in the scope of disclosure considerations.

Registrants will need to disclose in a note to the audited financial statements certain effects of severe weather events and other natural conditions (e.g., hurricanes, tornadoes, flooding), including the aggregate amounts and where in the financial statements they are presented. While the rules provide examples of severe weather events and other natural conditions, they do not define the terms. Companies will likely need to develop accounting policies to guide their disclosures in a manner consistent with the rules, facts and circumstances.

Following the adoption of the rules, the Fifth Circuit Court of Appeals granted a request for an administrative stay in response to one of the several lawsuits filed challenging the rules. The stay temporarily prevents the rules from taking effect while litigation continues. While more developments are expected, companies should not delay preparing for compliance. Unless stayed further, the rules will become effective 60 days after publication in the Federal Register and will be phased in starting in 2025. The compliance dates depend on a registrant's filer status and the type of disclosure.

# Accounting update

## FASB proposes clarifying accounting for induced conversions of convertible debt

The FASB proposed clarifying the requirements for determining whether to account for certain settlements of convertible debt instruments as induced conversions or extinguishments. An entity would be required to account for an early settlement as an induced conversion if the inducement offer includes the issuance of all consideration (in form and amount) issuable under the conversion privileges provided in the terms of the existing convertible debt instrument.

The proposal, which is based on a consensus-for-exposure of the Emerging Issues Task Force, is intended to address issues that stakeholders encountered when applying the guidance on induced conversions in Accounting Standards Codification (ASC) 470-20, *Debt — Debt with Conversion and Other Options*, to certain settlements of debt instruments with conversion options that may be settled entirely or partially in cash (i.e., cash convertible debt instruments). The current guidance focuses on conversions that require the issuance of all equity securities issuable under the existing conversion terms, but it does not address situations in which equity securities are not issued upon conversion (e.g., cash convertible debt instruments).

Entities would be permitted to apply the guidance either prospectively to convertible debt instruments settled after the effective date or retrospectively as of the beginning of the first comparative reporting period to convertible debt instruments settled after the adoption of Accounting Standards Update 2020-06.

## Estimating the annual effective tax rate in interim periods

As a reminder, at the end of each interim reporting period, a company is required to make its best estimate of the annual effective tax rate for the full fiscal year and apply that rate to year-to-date ordinary income. The calculation of the annual effective estimated tax rate can be affected by (1) operations in multiple jurisdictions, (2) expectations about whether current-year losses are realizable, (3) the tax benefit of an operating loss carryforward from a prior year that is realized because of current-year ordinary income and (4) tax law changes enacted in the period that affect taxes payable or refundable for the current year.

Management should make sure that forecasts used for estimating income taxes are consistent with those used for other purposes and incorporate the effects of current economic conditions. Companies also should monitor tax law changes in the US and other jurisdictions. The effects of a change in tax laws or rates on deferred tax balances are recognized as a discrete event as of the enactment date and should not be allocated to subsequent interim periods by adjusting the estimated annual effective tax rate. Similarly, the effects of a change in tax laws or rates on taxes payable or refundable for a prior year should be recognized discretely as of the enactment date.

A global minimum tax under the Pillar Two Global Anti-Base Erosion (GloBE) model rules is applicable to a multinational enterprise (MNE) group with annual consolidated financial statement revenue of more than EUR750 million. If an MNE group subject to tax under Pillar Two GloBE model rules has operations in a jurisdiction with an effective tax rate of less than 15%, a top-up tax will generally be imposed to bring the effective tax rate up to 15%. More than 25 countries have enacted legislation based on the GloBE model rules, and others have legislation in process or have announced their intent to enact legislation. For many countries that have enacted legislation, the laws are effective for fiscal years beginning on or after 31 December 2023.

In a response to a technical inquiry, the FASB staff said it believes that taxes under Pillar Two GloBE model rules should be treated as an alternative minimum tax when applying ASC 740, *Income Taxes*. Therefore, the incremental tax an entity needs to pay under the rules would generally be recognized as a current tax in the period it arises, and deferred tax assets and liabilities would not be recognized or adjusted for the estimated effects of the minimum tax in future periods. A company needs to consider in its estimated annual effective tax rate calculation any taxes under Pillar Two that would be due in fiscal year 2024 based on enacted legislation.

## Financial reporting considerations related to commercial real estate

Entities that own or operate commercial real estate and their lenders need to consider how their accounting and financial reporting may be affected by current macroeconomic factors, including the increased cost of capital, tighter lending standards and industry trends, including changes in cash flows and occupancy rates for certain properties. Stricter lending standards could create additional challenges for real estate entities that are looking to secure new financing or refinance existing loans and could require them to provide cash collateral. Registrants need to make sure these trends are addressed in their risk factor disclosures and management's discussion and analysis.

Changes in consumers' preferences about where they work, live, shop and eat have also impacted commercial real estate, resulting in declines in occupancy and property values, although not all commercial real estate has been impacted equally. When evaluating the accounting and reporting implications of these trends, real estate entities and lenders need to consider the type of commercial property (e.g., office, retail, residential, industrial, health care), the quality of the assets, conditions in the geographical region and other market dynamics. Management will also need to consider the entity's facts and circumstances and consider any potential effects consistently when preparing financial statements, including impacts to its cash flow projections used in prospective financial information and assumptions used in impairment assessments and going concern evaluations.

Lenders also need to consider current economic conditions when assessing the allowance for credit losses for various assets, including loans and net investments in both sales-type leases and direct financing leases. In addition, lenders may also need to consider the amount and timing of interest income recognized in the current environment. They may apply nonaccrual policies and methods to mitigate the risk of overstating interest income when the collection of that income is in doubt (e.g., when the value of collateral has deteriorated and repayment from the borrower is expected through the sale or operation of the collateral).

Registrants should have robust disclosure controls and procedures in place so they can timely disclose material information related to the economic environment and identify any triggering events that may warrant the filing of a Form 8-K. Companies also need to closely monitor developments and assess the implications for their business and their internal control over financial reporting.

# Regulatory developments

## SEC expands required SPAC disclosures, clarifies requirements for shell companies

The SEC adopted rules requiring a special purpose acquisition company (SPAC) to disclose the role of its sponsor, conflicts of interest, dilution and whether its board determined that the de-SPAC transaction is advisable and in the best interests of the SPAC and its shareholders.

The rules align financial statement requirements in de-SPAC transactions with those of traditional initial public offerings and require a redetermination of smaller reporting company status after a de-SPAC transaction. SPAC targets are deemed co-registrants, subjecting them to liability for untrue material statements or material omissions. The rules also expand disclosures about future performance projections in SEC filings and amend the definition of a "blank check company" to make the safe harbor from liability for forward-looking statements unavailable to SPACs.

In addition, the rules amend Item 10(b) of Regulation S-K, which allows management to present projected financial information that has a reasonable basis in SEC filings, to require registrants to "clearly distinguish" projected measures that are not based on historical financial results from those that are and to present corresponding historical results with equal or greater prominence. The rules are effective on 1 July 2024, and the related structured data requirements are effective 30 June 2025.

## SEC amends Form PF to expand private fund reporting requirements

The SEC amended Form PF, the confidential reporting form for certain SEC-registered investment advisers to private funds, to expand certain reporting requirements.

Hedge fund advisers and their advised hedge funds now need to report additional information on investment strategies, counterparty exposures, and trading and clearing mechanisms. Large hedge fund advisers now need to report additional information for hedge funds with a net asset value of $500 million or more, including fund exposure reporting, risk metrics and liquidity reporting, among other things.

Private fund advisers and their advised private funds need to report additional basic information, including assets under management, withdrawal and redemption rights, gross asset value and net asset value, inflows and outflows, base currency, borrowings and types of creditors, fair value hierarchy, beneficial ownership and fund performance.

The amendments also change how private fund advisers report complex structures by generally requiring (1) separate reporting for each component fund of a master-feeder arrangement and parallel fund structure and (2) aggregated reporting for trading vehicles used by reporting funds. In addition, the amendments eliminate the requirement for large hedge fund advisers to report certain aggregated information about the funds they manage that could obscure the data about hedge funds, including by masking the directional exposures of individual funds.

Registered investment advisers must comply with the amendments one year after publication in the Federal Register.

## SEC rules expand definitions of dealers and government securities dealers

The SEC adopted rules under the Securities Exchange Act of 1934 (the Act) that define a "dealer" or "government securities dealer" as a person who engages, as part of a regular business, in either of the following activities:

- Regularly expresses trading interest that is at or near the best available prices on both sides of the market for the same security and that is communicated and represented in a way that makes it accessible to other market participants
- Earns revenue primarily from capturing bid-ask spreads, by buying at the bid and selling at the offer, or from capturing any incentives offered by trading venues to liquidity-supplying trading interest

The rules clarify that a person who does not engage in these activities may still be a dealer or government securities dealer.

The rules are intended to address SEC concerns that certain market participants, such as proprietary or principal trading firms, act as de facto market makers without registration and with limited regulatory oversight.

Absent an exception or exemption, a dealer or government securities dealer is required to (1) register with the SEC under Section 15(a) or Section 15C of the Act (broker-dealer registration), (2) join a self-regulatory organization (SRO) and (3) comply with federal securities laws and regulatory obligations, as well as SRO and US Treasury rules and requirements. Proprietary trading firms, registered investment advisers, private funds and other entities that previously did not meet the definitions of dealer or government securities dealer may now meet either definition.

The revised definitions exclude any person that has or controls total assets of less than $50 million, investment companies registered under the Investment Company Act of 1940, central banks, sovereign entities and international financial institutions as defined in the rules.

The rules are effective on 29 April 2024, with compliance required one year later.

# Other considerations

## Updates on other climate reporting rulemaking

The US Chamber of Commerce and several other business coalitions filed a lawsuit challenging California's enactment of two climate-disclosure laws applicable to both public and private entities that do business in the state and meet certain annual revenue thresholds. Both laws require initial disclosures in 2026. However, California Gov. Gavin Newsom did not include funding in this year's proposed budget to develop the regulations for the two climate-disclosure laws, which may impact implementation timelines.

Separately, the European Commission increased the revenue and total assets thresholds used to determine whether a European Union (EU) entity or subsidiary is in the scope of the CSRD. The revenue threshold was increased to EUR50 million from EUR40 million, and the total assets threshold was increased to EUR25 million from EUR20 million, which could affect whether a subsidiary of a US multinational is in the scope of the CSRD. Companies may want to revisit their scoping analysis.

The EU agreed to defer the release date of the sector-specific and third-country European Sustainability Reporting Standards to June 2026.

Some EU Member States have started to incorporate the CSRD into their local laws, with France incorporating in their laws the previous revenue and total assets thresholds. However, there is still a significant majority of Member States that have not incorporated the CSRD into their local laws, which is required by 16 June 2024. Companies should continue to monitor developments in their relevant jurisdictions.

## Summary of open comment periods

| Proposal | Comment period ends |
|---|---|
| Qualifying Venture Capital Funds Inflation Adjustment (SEC proposal) | 22 March 2024 |
| False or Misleading Statements Concerning PCAOB Registration and Oversight (PCAOB proposal) | 12 April 2024 |

# Reference library

Click on any of the EY publications below, all of which are available free of charge on AccountingLink at www.ey.com/en_us/assurance/accountinglink.

## To the Point

- SEC adopts rules requiring registrants to disclose certain climate-related information (7 March 2024)
- SEC rules require new SPAC disclosures and clarify reporting requirements for shell companies (25 January 2024)
- FASB requires public entities to disclose significant segment expenses and other segment items (21 December 2023)
- FASB proposes clarifying accounting for induced conversions of convertible debt instruments (21 December 2023)

## Technical Line

- How the climate-related disclosures under the SEC proposal, the ESRS and the ISSB standards compare (31 January 2024)
- How the EU's Corporate Sustainability Reporting Directive affects non-EU-based multinationals (31 January 2024)
- Navigating the requirements of the leases guidance for federal lessors and lessees (31 January 2024)
- A closer look at how insurers will have to change their accounting and disclosures for long-duration contracts (17 January 2024)
- FASB issues guidance requiring additional income tax disclosures (20 December 2023)
- How the new revenue standard affects health care entities (18 December 2023)
- Financial reporting considerations for commercial real estate entities and their lenders (29 November 2023)

## Other

- NAIC Bulletin – Fall 2023 edition (25 January 2024)
- Accounting pronouncements effective in 2023 (11 January 2024)
- SEC in Focus – January 2024 (11 January 2024)
- Quarterly Tax Developments – December 2023 (11 January 2024)

## On-demand webcasts

- Navigating Derivatives and hedge accounting
- What audit committees need to know to prepare for 2024
- EY 2024 global economic outlook for business leaders
- Navigating the new global tax landscape
- Spotlight on BEPS 2.0 for US MNEs (January 2024)
- BEPS 2.0 and Pillar Two implementation developments
- Top priorities for boards in 2024
- Domestic tax quarterly: a focus on state tax matters
- A closer look at the SEC climate-related disclosures rule
- IRA: monetization benefits for companies across all sectors
- Spotlight on BEPS 2.0 for US MNEs (March 2024)
- Accounting for income taxes: a quarterly perspective

## Upcoming webcasts

- What you need to know for Q1 2024 financial reporting (Live – offering 1 of 2) (21 March 2024)
- What you need to know for Q1 2024 financial reporting (Replay – offering 2 of 2) (26 March 2024)
- Audit committee considerations for Q1 2024 (9 April 2024)
- US corporate income tax compliance (24 April 2024)

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