In this issue:

Financial reporting briefs

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

September 2024

Building a better working world

Accounting update

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

In our Accounting update *section, we discuss the FASB's proposal that would refine derivative scope exceptions and SEC staff considerations related to the FASB's new guidance on segment disclosures.*

In our Regulatory developments *section, we discuss trends in SEC staff comment letters and provide updates on other SEC 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.*

FASB proposal would refine derivative scope exceptions and clarify accounting for certain share-based payments

The Financial Accounting Standards Board (FASB) proposed excluding from the scope of derivative accounting non-exchange traded contracts with underlyings that are based on the operations or activities of one of the parties to the contract.

The proposal would also amend the predominant characteristics assessment in Accounting Standards Codification (ASC) 815, *Derivatives and Hedging*, applicable when a contract (or an embedded feature) contains multiple underlyings, and only some of them qualify for a scope exception from derivative accounting. Under the proposal, a contract (or embedded feature) would not be subject to the requirements of ASC 815 if the underlying that has the largest expected effect on changes in the fair value of the contract (or embedded feature) qualifies for a scope exception.

In addition, the proposal would clarify that an entity receiving a share-based payment from a customer that is consideration for the transfer of goods or services in a revenue contract would apply the guidance on noncash consideration in ASC 606, *Revenue from Contracts with Customers*. The entity would not apply the guidance in ASC 815 and ASC 321, *Investments — Equity Securities*, unless and until the share-based payment is recognized as an asset under ASC 606.

The proposed amendments are intended to address stakeholder questions about how the definition of a derivative and related scope exceptions would apply to contracts such as bonds with interest payments based on environmental, social and governance (ESG) metrics, research and development funding arrangements, and litigation financing arrangements. The proposal is also intended to better portray the economics of these contracts in the financial statements and reduce the cost and complexity of applying the guidance in ASC 815.

SEC staff considerations related to FASB's segment disclosure guidance

The Securities and Exchange Commission (SEC) staff has said its review of 2024 annual financial statements will focus closely on segment reporting, including compliance with the FASB's new segment disclosure guidance in Accounting Standards Update (ASU) 2023-07.

The SEC staff has said additional segment profitability measures a public entity chooses to disclose under ASU 2023-07 that are not determined in accordance with US GAAP would be considered non-GAAP financial measures because ASC 280 does not (1) require their disclosure or (2) expressly permit their disclosure by prescribing or otherwise specifying the additional measures that may be disclosed.

Based on recent discussions with the SEC staff, we understand that although Item 10(e) of Regulation S-K prohibits the inclusion of non-GAAP measures on the face of the financial statements or in the accompanying footnotes, the staff will not object to the disclosure of additional segment profitability measures that are not determined in accordance with US GAAP in the footnotes, as long as they otherwise comply with Regulation G, Item 10(e) of Regulation S-K and the related SEC staff's compliance and disclosure interpretations (C&DIs), including the requirement that the non-GAAP measure not be misleading.

We encourage companies to carefully consider this staff guidance and engage with their legal counsel and independent auditors when considering disclosure of additional non-GAAP segment measures of profit or loss in the financial statements.

ASU 2023-07 amends the guidance in ASC 280, *Segment Reporting*, to require a public entity to disclose significant segment expenses and other segment items on an annual and interim basis and provide in interim periods all disclosures about a reportable segment's profit or loss and assets that are currently required annually. Public entities with a single reportable segment are required to provide the new disclosures and all the disclosures currently required under ASC 280.

The ASU also allows public companies to disclose more than one measure of a segment's profit or loss, provided that such measures are used by the chief operating decision-maker (CODM) to assess performance and allocate resources. Under ASC 280, the segment profitability measure that is required to be reported is the one that is most consistent with US GAAP. All other segment measures used by the CODM represent additional measures of segment profitability.

The guidance is effective for all public entities for fiscal years beginning after 15 December 2023 and interim periods beginning after 15 December 2024 and should be applied retrospectively to all periods presented in financial statements.

What's next in FASB standard setting

The FASB is expected to issue a proposed ASU in the near future with a 60-day comment period that would make targeted improvements to ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*.

The FASB is also expected to issue proposals on accounting for and disclosure of software costs, accounting for government grants, accounting for environmental credit programs, share-based consideration payable to a customer and narrow-scope improvements to interim reporting, among others.

The Board is expected to issue final ASUs this year to clarify the requirements for determining whether to account for certain early settlements of convertible debt instruments as induced conversions and to require disclosure of disaggregated income statement expenses.

Regulatory developments

Trends in 2024 SEC staff comment letters

The SEC staff continued to focus on many of the same topics as last year in comment letters issued to registrants about their disclosures in periodic SEC filings in the year ended 30 June 2024. Management's discussion and analysis (MD&A) and non-GAAP financial measures continued to draw the most scrutiny from the SEC staff, followed by segment reporting, revenue recognition, goodwill and intangible assets, and business combinations.

The volume of staff comment letters issued on periodic reports remained consistent with last year, when it was significantly higher compared with each of the previous four years. The average number of comment letters (or rounds of comments) the SEC staff issued for each topic to resolve its concerns also was consistent with last year but remained elevated compared to historical levels.

Looking ahead, we expect the SEC staff to continue to focus on the topics mentioned above. The SEC staff may also expand its comments to other financial reporting topics, including disclosures made in response to recently issued SEC rules and financial accounting standards. These areas could include cybersecurity, clawbacks, segment reporting and disclosures on supplier finance programs.

In addition, the SEC staff may also focus on areas of emerging risk, such as artificial intelligence and crypto assets.

SEC staff issues guidance on cybersecurity incidents involving ransomware

The SEC staff published C&DIs relating to the disclosure of material cybersecurity incidents involving ransomware payments under Item 1.05 of Form 8-K.

The C&DIs clarify that a ransomware payment made by a registrant and the subsequent cessation or apparent cessation of the related cybersecurity incident does not relieve the registrant of the requirement to determine the materiality of the incident and to disclose it when required. The registrant cannot conclude that the incident is immaterial simply because of the its cessation.

The C&DIs also clarify that a registrant cannot necessarily conclude that a cybersecurity incident is immaterial based only on the size of the ransomware payment or on whether the registrant is reimbursed for the ransomware payment under an insurance policy.

Disclosure of a series of ransomware attacks over time, either by a single threat actor or multiple threat actors, may be required even if the registrant determines that each incident is individually immaterial.

SEC staff clarifies guidance on voluntary cybersecurity incident reporting

Erik Gerding, Director of the SEC's Division of Corporation Finance (DCF), clarified that if a registrant chooses to voluntarily disclose a cybersecurity incident that is determined not to be material or for which a materiality determination has not yet been made, it should not make the disclosure under Item 1.05 of Form 8-K. Instead, registrants are encouraged to disclose such incidents under a different item of Form 8-K, such as Item 8.01, *Other Events*.

Mr. Gerding said a company that discloses an immaterial incident (or one for which it has not yet made a materiality determination) under Item 8.01 and subsequently determines the incident is material should file under Item 1.05 on Form 8-K within four business days of that determination.

Mr. Gerding also clarified that Item 1.05 does not prohibit the sharing of information beyond what is included in Form 8-K and that discussions regarding a cybersecurity incident could implicate the selective disclosures rules in Regulation FD, depending on the information disclosed and to whom that information is disclosed.

Mr. Gerding suggested there are ways registrants can privately share additional information about a material cybersecurity incident without implicating Regulation FD, and exclusions from Regulation FD may apply.

SEC amends reporting requirements for certain investment companies

The SEC amended Form N-PORT and Rule 30b1-9 of the Investment Company Act of 1940 (1940 Act) to require registered investment companies to provide monthly rather than quarterly reporting and to provide such reporting within 30 days after the end of each month rather than the current requirement to file within 60 days of quarter end. The reports, which will include disclosures of portfolio holdings, will be made public 60 days after the end of each month.

Additionally, open-end funds subject to Rule 22e-4 under the 1940 Act (the liquidity rule) need to report information on Form N-CEN about the service providers used to fulfill liquidity rule requirements (e.g., certain identifying information about the liquidity service providers and the asset classes for which the liquidity service providers are used).

The SEC also published liquidity rule interpretive guidance on (1) the frequency of classifying the liquidity of fund investments, (2) the meaning of cash in the liquidity rule and (3) determining and reviewing highly liquid investment minimums.

The amendments will be effective 17 November 2025. Fund groups with net assets of less than $1 billion have until 18 May 2026 to comply with the Form N-PORT amendments.

SEC approves certain PCAOB new and amended standards and amended rule

The SEC approved the following new and amended standards and amended ethics rule adopted by the Public Company Accounting Oversight Board (PCAOB):

- New Quality Control Standard, QC 1000, *A Firm's System of Quality Control*, and related amendments
- New Auditing Standard, AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, and related amendments
- Amended standard related to the use of technology-assisted analysis in conducting an audit
- Amended ethics rule governing the liability of an associated person

The SEC in its order related to QC 1000 encouraged the PCAOB to provide further implementation guidance on the related amendments in general and to the new external quality control function role in particular. The SEC stated in its order related to the amended standard on the use of technology-assisted analysis that the amendments do not preclude a risk-based approach to testing external information, and it encouraged the PCAOB to provide further implementation guidance on this point.

Other considerations

Companies should consider AICPA guide updates when valuing privately held equity securities

When valuing privately held equity securities issued as share-based compensation, companies with secondary market activity should consider the draft updated chapters of the American Institute of Certified Public Accountants (AICPA) Accounting and Valuation Guide, *Valuation of Privately-Held-Company Equity Securities Issued as Compensation*.

The draft updates, which reflect what are viewed to be best practices, enhance the frameworks for (1) determining the impact of secondary market transactions on the value of the equity securities underlying share-based compensation awards and (2) assessing whether compensation cost should be recognized for these transactions.

Under the draft guidance, the weight placed on secondary market transaction prices compared to other indications of fair value will depend on the facts and circumstances. However, we believe that the application of the draft updates may result in heavier weighting of secondary market transactions as compared to past practices.

Summary of open comment periods

Items are FASB proposals unless otherwise noted.

Proposal	Comment period ends
Draft chapters of the AICPA's Accounting and Valuation Guide, *Valuation of Privately-Held-Company Equity Securities Issued as Compensation*	20 September 2024
Proposed Accounting Standard Update — Derivatives (Topic 815) — *Derivatives Scope Refinements*	21 October 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/technical/accountinglink.

To the Point

- AICPA issues draft updates to its accounting and valuation guide on privately held equity securities (22 Aug 2024)
- Proposal would refine derivative scope exceptions and clarify the accounting for certain share-based payments (25 July 2024)
- OMB makes significant revisions to Uniform Guidance for recipients of federal funds (25 July 2024)

Technical Line

- A closer look at the FASB's new segment disclosure requirements (9 September 2024)
- How the climate-related disclosures under the SEC rules, the ESRS and the ISSB standards compare (18 July 2024)
- Accounting considerations for intangible assets affected by the FTC's final noncompete rule (11 July 2024)
- Applying the SEC's requirements for significant acquired businesses (26 June 2024)
- Applying the definition of a business to oil and gas transactions (20 June 2024)
- Navigating the reporting requirements related to an initial public offering (13 June 2024)

Financial reporting developments

- Impairment or disposal of long-lived assets (19 August 2024)
- Asset retirement obligations (1 August 2024)
- Credit impairment under ASC 326 (31 July 2024)
- Lease accounting — Accounting Standards Codification 842, Leases (31 July 2024)
- Statement of cash flows (30 July 2024)
- Derivatives and hedging (25 July 2024)
- Postretirement benefits (24 July 2024)
- Insurance contract modifications or exchanges (22 July 2024)
- Accounting for certain life insurance and annuity products (22 July 2024)
- Intangibles — Goodwill and other (26 June 2024)
- Equity method investments and joint ventures (26 June 2024)
- Business combinations (26 June 2024)
- Consolidation: Determination of a controlling financial interest and accounting for changes in ownership interests (24 June 2024)

Comment letters

- PCAOB proposal on substantive analytical procedures (12 August 2024)
- PCAOB amendments related to technology-assisted analysis (TAA) (12 August 2024)

Other

- SEC Reporting Update — Highlights of trends in 2024 SEC staff comment letters (12 September 2024)
- SEC in Focus — July 2024 (18 July 2024)
- Effective date matrix as of 30 June 2024 (10 July 2024)

On-demand webcasts

- BEPS 2.0: Ongoing activity on Pillars One and Two (10 September 2024)
- Tax in a time of transition (9 August 2024)
- Global economic outlook: Thriving in a new normal (30 July 2024)
- Spotlight on BEPS 2.0 for US MNEs (26 June 2024)
- Tax in a time of transition: legislative, economic, regulatory and IRS developments (21 June 2024)
- AI challenges and opportunities: considerations for boards (20 June 2024)
- Accounting for income taxes: a quarterly perspective (18 June 2024)
- How to navigate cybersecurity in the AI world (18 June 2024)

Upcoming webcasts

- What you need to know for Q3 2024 financial reporting (Live offering — 1 of 2) (19 September 2024)
- What you need to know for Q3 2024 financial reporting (Replay offering — 2 of 2) (24 September 2024)