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Financial reporting briefs

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

June 2024

Building a better working world

Accounting update

Welcome to the June 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 new guidance on profits interest awards and other developments.*

In our Regulatory developments *section, we discuss the SEC's stay on its climate-related disclosure rules, the PCAOB's new standard on quality control 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.*

FASB clarifies when profits interest awards are in the scope of ASC 718

The Financial Accounting Standards Board (FASB or Board) issued final guidance to add an example to Accounting Standards Codification (ASC) 718, *Compensation — Stock Compensation*, showing how an entity applies the scope guidance to determine whether a profits interest award should be accounted for as a share-based payment arrangement under ASC 718 or another standard.

Some entities compensate employees or other service providers by granting profits interest awards. While the term "profits interest" is not defined in US GAAP, these awards generally give the grantee an opportunity to participate in future profits and/or equity appreciation of the entity but do not give them rights to existing net assets of the entity. The new guidance is intended to reduce the complexity in determining whether profits interest and similar awards are in the scope of ASC 718 and to reduce diversity in practice. While profits interest awards are typically issued by private companies, the guidance applies to all entities that issue these types of awards, including public business entities.

The example in the new guidance describes four fact patterns and illustrates how an entity evaluates common terms and characteristics of profits interest and similar awards to reach a conclusion about whether an award meets the scope conditions in ASC 718-10-15-3. The fact patterns are not intended to be all inclusive and do not reflect scenarios that require significant judgment to determine whether an arrangement meets the scope criteria.

For public business entities, the guidance is effective for fiscal years beginning after 15 December 2024, and interim periods within those fiscal years. For other entities, it is effective for fiscal years beginning after 15 December 2025, and interim periods within those fiscal years. Early adoption is permitted.

Entities can apply the guidance either retrospectively to all periods presented in the financial statements in accordance with ASC 250, *Accounting Changes and Error Corrections*, or prospectively to profits interest awards granted or modified on or after the effective date with a disclosure that describes the nature and reason for the change in accounting principle that resulted from the adoption of the guidance.

Standard-setting activities expected in the third quarter

The FASB is expected to issue a final Accounting Standards Update in the third quarter to clarify the requirements for determining whether to account for certain settlements of convertible debt instruments as induced conversions or extinguishments.

The Board is also expected to issue four proposals in the third quarter. One proposal would refine the scope of ASC 815, *Derivatives and Hedging*, and address the interaction between ASC 606, *Revenue from Contracts with Customers*, and other ASC topics related to the grantee's accounting of a share-based payment in a contract with a customer. Another proposal would make certain improvements to the hedge accounting guidance in ASC 815. In addition, the Board is expected to issue proposals on narrow-scope improvements to ASC 270, *Interim Reporting*, and on accounting for government grants.

FASB announces members of reconstituted Emerging Issues Task Force

The FASB revised the membership makeup and operating procedures of its Emerging Issues Task Force (EITF) in response to stakeholder feedback on a recent agenda consultation.

The Board named Paul Beswick, Thomas Barbieri, Jack Ciesielski, David Gonzales, Robert Malhotra, Kevin McBride, Dan Palomaki, Jeremy Perler, Matthew Schell, Kate Sturgess and Curt Weller to the reconstituted EITF.

As part of its new operating procedures, the EITF will be able to manage its own agenda and accept potential agenda requests directly from external stakeholders. The EITF will provide recommendations to the FASB to add projects to the Board's technical agenda and recommend solutions for the Board's consideration. The EITF will discuss "Determining the accounting acquirer" (Issue 24-A) at its 14 June meeting.

Jackson M. Day joins FASB as director of technical activities

The FASB named Jackson M. Day as director of technical activities, starting in July. He will join the FASB from Ernst & Young LLP, where he is a partner working in Professional Practice.

Regulatory developments

SEC voluntarily stays climate-related disclosure rules

The Securities and Exchange Commission (SEC or Commission) voluntarily stayed its climate-related disclosure rules. Absent the stay, the rules would have been effective on 28 May 2024 and phased in starting in 2025, depending on the registrant's filer status and the type of disclosure.

The rules would require registrants to disclose climate-related information in registration statements and annual reports, including disclosures in the audited financial statements (e.g., certain effects of severe weather events and other natural conditions, certain amounts related to carbon offsets and renewable energy credits or certificates) and outside the financial statements (e.g., material climate-related risks, material climate-related targets or goals).

Following the SEC's adoption of the rules in early March, several lawsuits were filed to challenge them, and some of the lawsuits were subsequently consolidated into the Eighth Circuit Court of Appeals. The SEC issued the stay order in early April to facilitate the judicial resolution of the challenges to the rules. The SEC said it will continue to vigorously defend the rules' validity in court.

It is uncertain how the litigation may affect the adopted compliance timelines. While the stay may have dampened the sense of urgency to implement the rules, companies should consider continuing their implementation activities, particularly if they are subject to other overlapping climate-related disclosure requirements, such as the European Union's Corporate Sustainability Reporting Directive.

The SEC has said registrants should continue to consider the Commission's 2010 guidance on disclosures related to climate change because it addresses how various existing rules (e.g., description of business, risk factors, legal proceedings, management's discussion and analysis) may require disclosure about climate-related matters. The SEC staff may continue to issue comment letters addressing compliance with this guidance.

SEC tightens rules on internet investment adviser registration

The SEC adopted an amended rule to require certain internet investment advisers that rely on the exemption from the prohibition on SEC registration for smaller investment advisers to (1) provide investment advice to its clients solely through an operational interactive website and (2) represent on Schedule D of its Form ADV that, among other things, it has an operational interactive website. The amendments also eliminate the current rule's de minimis exception, which allowed internet advisers to have a limited number of non-internet clients. An adviser relying on the exemption must comply with the rule by 31 March 2025. An adviser that is no longer eligible to rely on the amended exemption must withdraw its registration with the SEC by filing a Form ADV-W by 29 June 2025.

PCAOB adopts new quality control standard for auditors

The Public Company Accounting Oversight Board (PCAOB) adopted a new standard, subject to SEC approval, to require all PCAOB-registered public accounting firms to identify their risks and design a quality control system that includes policies and procedures to guard against those risks.

The standard will require firms that perform audits of public companies or SEC-registered brokers and dealers to implement and operate the quality control system they design, monitor the system, and take remedial action when policies and procedures are found to be ineffective. It also will require PCAOB-registered firms to annually evaluate their quality control system and report the results to the PCAOB.

Firms that audit more than 100 issuers annually will be required to establish an external oversight function for their quality control system, which would be responsible for, at a minimum, evaluating the significant judgments made and the related conclusions reached by the firm when evaluating and reporting on the effectiveness of its quality control system.

The new standard will take effect on 15 December 2025.

PCAOB adopts standard on the auditor's general responsibilities

The PCAOB adopted a new auditing standard subject to SEC approval, to modernize, clarify and streamline the general principles and responsibilities of the auditor in conducting an audit.

The standard, referred to as AS 1000, and the related amendments, clarify the auditor's responsibility to evaluate whether the financial statements are "presented fairly", as well as clarify the engagement partner's due professional care responsibilities by adding specificity to certain audit performance principles set out in the PCAOB's standards.

The standard also will accelerate the documentation completion date by reducing the maximum period for the auditor to assemble a complete and final set of audit documentation to 14 days from 45 days after the report release date. This will allow the PCAOB to potentially begin its inspection process sooner after the completion of an audit.

The new requirements will be effective for audits of financial statements conducted under PCAOB standards for fiscal years beginning on or after 15 December 2024. For certain firms, the amendment related to the documentation completion date will take effect for audits of financial statements for fiscal years beginning on or after 15 December 2025.

PCAOB proposals would expand public reporting by audit firms

The PCAOB issued two proposals that would require certain registered public accounting firms to expand public reporting about the firms, their audit practices and audit engagements.

One proposal would require reporting of firm-level metrics for firms that serve as lead auditor for at least one accelerated filer or large accelerated filer and reporting of engagement-level metrics for audits of accelerated filers and large accelerated filers. Such metrics would cover partner and manager involvement, workload, audit resources (i.e., use of auditor's specialists and shared service centers), experience of audit personnel, industry experience of audit personnel, retention and tenure, audit hours and risk areas (engagement-level only), allocation of audit hours, quality performance ratings and compensation (firm-level only), audit firms' internal monitoring, and restatement history (firm-level only).

The other proposal would require additional reporting of audit firm financial, governance and network information and would shorten the timeframe for all reporting on the Special Reporting Form to 14 days from 30 days (or more promptly, as warranted). It would also establish a new confidential special reporting requirement for events material to a firm's organization, operations, liquidity or financial resources, or provision of audit services, and specifically for significant cybersecurity events.

While some firms already publicly disclose certain firm-level metrics through their audit quality reports, transparency reports or other documents, the PCAOB said the disclosures are inconsistent across firms, and most of them are voluntary, so firms are free to revise or discontinue such reporting anytime. In addition, the PCAOB said there is a lack of incentive for firms to provide accurate, standardized and decision-relevant information about their firms and the engagements they perform.

PCAOB staff highlights considerations related to commercial real estate

The PCAOB released a staff Spotlight report that highlights considerations for auditors as they plan and conduct audits and reviews of interim financial information of companies with exposure to commercial real estate amid reduced demand for office and retail space in many industries due to the shift to hybrid and remote work.

The Spotlight provides a set of questions that auditors should consider, depending on the facts and circumstances of the company under audit, when identifying and assessing risks, including the risk of fraud. It also provides reminders related to planning and performing audit procedures in areas such as asset impairment, allowance for credit losses and going concern, as well as interim review considerations. In addition, it noted that the current conditions in the commercial real estate industry may require more communications between auditors and audit committees when there are significant changes to the auditor's planned audit strategy or changes in significant risks initially identified.

SEC appoints Erica Williams to a second term as PCAOB Chairperson

The SEC said it appointed Erica Y. Williams to a second term as PCAOB Chairperson, beginning 25 October 2024 through 24 October 2029. Chair Williams was sworn in on 10 January 2022.

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

- FASB clarifies when profits interest awards are in the scope of ASC 718 (21 March 2024)

Technical Line

- How the climate-related disclosures under the SEC rules, the ESRS and the ISSB standards compare (6 June 2024)
- Lessee accounting considerations for retailers (30 May 2024)
- How the revenue standard affects retail and consumer products entities (22 April 2024)
- Accounting for DrillCo arrangements (8 April 2024)
- A closer look at California's recently enacted climate disclosure laws (4 April 2024)
- A closer look at the SEC's climate-related disclosure requirements (3 April 2024)
- Accounting considerations for the global minimum tax under the Pillar Two GloBE model rules (27 March 2024)
- Navigating the requirements for merging with a special purpose acquisition company (20 March 2024)
- Financial reporting considerations for commercial real estate entities and their lenders (29 November 2023)

Financial reporting developments

- Foreign currency matters (2 June 2024)
- Share-based payment (30 May 2024)
- Transfers and servicing of financial assets (22 May 2024)
- Real estate project costs (12 May 2024)
- Accounting changes and error corrections (1 May 2024)
- Exit or disposal cost obligations (29 April 2024)
- Discontinued operations (29 April 2024)
- Bankruptcies, liquidations and quasi-reorganizations (24 March 2024)

Comment letters

- PCAOB proposed rule on false or misleading statements concerning PCAOB registration and oversight (11 April 2024)

Other

- Guide to preparing carve-out financial statements (13 May 2024)
- NAIC Bulletin – Spring 2024 edition (24 April 2024)
- SEC in Focus – April 2024 (10 April 2024)
- Quarterly Tax Developments – March 2024 (9 April 2024)
- Effective date matrix as of 31 March 2024 (2 April 2024)

On-demand webcasts

- Audit committee considerations for Q1 2024
- US corporate income tax compliance
- Spotlight on BEPS 2.0 for US MNEs (8 May 2024)
- DOJ's new approach to corporate accountability
- US Election Year Economic Insights Webcast
- Spotlight on BEPS 2.0 for US MNEs (22 May 2024)
- Domestic tax quarterly webcast series: a focus on state tax matters – June 2024

Upcoming webcasts

- What you need to know for Q2 2024 financial reporting (Live offering – 1 of 2) (13 June 2024)
- What you need to know for Q2 2024 financial reporting (Replay – offering 2 of 2) (18 June 2024)
- AI challenges and opportunities: considerations for boards (20 June 2024)