Year-end Financial Reporting Reminders Q4 2021

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Year-end Financial Reporting Reminders
Fourth Quarter 2021

As 2021 draws to a close, here are some considerations for preparing your annual financial statements.

New MD&A requirements

For public companies, the Securities and Exchange Commission (SEC) amended Regulation S-K to remove certain disclosure requirements and revise others to streamline the disclosures provided in the MD&A section of Form 10-K.

Item 302(a) of Regulation S-K no longer requires a table of selected quarterly financial data for the two most recent fiscal years unless there has been a material change to comprehensive income.

The requirement in Item 301 of Regulation S-K to present a table of selected financial data for each of its last five years was eliminated.

A number of changes to Item 303 of Regulation S-K were made to modernize and simplify the MD&A requirements, including the following:

- Providing objectives of MD&A disclosure. The objectives focus on disclosure of material information relevant to assessing a registrant's financial condition, results of operations and cash flows.
- A discussion of the reasons for material changes in financial statement line items from period to period in both quantitative and qualitative terms.
- Disclosure of prospective information that is *reasonably likely* to have a material impact throughout MD&A.
- The requirements for liquidity and capital resources have been combined. Companies must disclose their ability to generate and obtain adequate amounts of cash to meet their operating requirements and plans in the short-term and long-term to meet those needs.
- A contractual obligations table is no longer required.
- The requirement to disclose off-balance sheet arrangements in a separate section was removed. Instead, disclosures of material off-balance sheet arrangements should be disclosed throughout the MD&A.

ESG Disclosures

The SEC, investors, and other readers of financial statements are expecting companies to provide more disclosure around activities related to the environment (e.g., climate change and conservation of natural resources), social issues (e.g., inclusion, diversity, and human capital), and governance (e.g., internal oversight). Investors, vendors, and the general public are expecting most companies to be more progressive and proactive in these areas and disclose what plans are in place and actions have been taken to enhance the company's performance in this regard.

On September 22, 2021, the SEC published a sample comment letter to companies regarding climate change disclosures to give public companies a sense of what types of comments they might have in that regard. The letter focused on climate change disclosures in discussing risk factors and management's discussion and analysis (MD&A) of impacts on operating results.

Companies should consider developing and disclosing appropriate metrics to help readers of their financial statements assess how well they are performing in these areas over time. They also should evaluate how their disclosures compare to their peers to avoid being viewed as falling behind in this regard to mitigate reputational risk.

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SEC Comment Letter Trends

Public companies should be mindful of recent SEC comment letter trends to reduce the likelihood of receiving a comment letter on their Form 10-K filing for 2021. The most common topics in the 2021 SEC comment letters focused on disclosures regarding:

1. Non-GAAP financial measures
2. MD&A
3. Segment reporting
4. Revenue recognition

For non-GAAP measures, companies should be careful that the non-GAAP measures are not given more prominence than GAAP measures. Also, non-GAAP measures should be reasonable, applied on a consistent basis, and allow readers to reconcile those measures to the GAAP financial statements. Non-GAAP measures have been become more common to adjust for anomalous effects of COVID-19 on normal business operations.

Comments on MD&A often request more information to be provided in certain areas or inquire about inconsistencies between the MD&A disclosures and other public comments made by the company in shareholder or investor presentations or earnings calls.

Segment reporting comments often focus on the propriety of aggregating operating segments into a single or a small number of reportable segments.

Revenue recognition comments pertain to disaggregated revenue disclosures, identification of performance obligations, and satisfaction of performance obligations.

Internal Controls

Companies should monitor their assessment of the effectiveness of internal controls over financial reporting (ICOFR). If material weaknesses exist, public companies must disclose them as part of their Form 10-K filings. Nonpublic companies may have to disclose material weaknesses to regulators or others to comply with contract covenants.

LIBOR

Banks are required by regulators to stop using LIBOR as a reference rate in loans and other contracts by the end of the year. (See our Q3 article, *A Farewell to LIBOR*, for more details.) Many banks are starting to use the Secured Overnight Financing Rate (SOFR) and other market interest rate indices as a substitute for LIBOR. Companies with floating rate loans, derivative contracts (e.g., interest rate swaps, caps, and floors), and other contracts formerly tied to LIBOR with banks will need to prepare for the change in measuring such contracts for accounting and financial reporting purposes.

The FASB has granted relief from certain accounting implications related to this change in Accounting Standards Update (ASU) Nos. 2020-04 and 2021-01, *Reference Rate Reform (Topic 848)*. The amendments in this Update apply to contract modifications that replace a reference rate affected by reference rate reform (including rates referenced in fallback provisions) and contemporaneous modifications of other contract terms related to the replacement of the reference rate (including contract modifications to add or change fallback provisions).

ASU 2020-04 provides optional expedients in a new Topic 848 for applying the requirements of certain Topics or Industry Subtopics in the Codification for contracts that are modified because of reference rate reform and meet certain scope requirements. ASU 2021-01 clarifies the scope of contracts covered by Topic 848.

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Taxes

The Federal government recently enacted new infrastructure legislation and is expected to enact significant spending legislation by year-end.

If significant new Federal tax laws are enacted before year-end (e.g., changes in tax rates, deductions, or taxable income), companies will need to assess the impact to their effective tax rates, current taxes payable (or receivable), and deferred taxes. That includes reassessment of future realization of tax benefits from net operating loss or tax credit carryforwards. For deferred tax assets, companies may need to reassess the adequacy of any valuation allowance, revisions to tax planning strategies, and any reserve for uncertain tax positions.

New Accounting Standards Effective in 2021

The following accounting standards are effective for public calendar year companies in 2021:

- ASU 2021-03, Intangibles — Goodwill and Other (Topic 350): Accounting Alternative for Evaluating Triggering Events
- ASU 2021-01, Reference Rate Reform (Topic 848): Scope
- ASU 2020-10, Codification Improvements
- ASU 2020-09, Debt (Topic 470): Amendments to SEC Paragraphs Pursuant to SEC Release No. 33-10762 (SEC Update)
- ASU 2020-08, Codification Improvements to Topic 310-20, Receivables—Nonrefundable Fees and Other Costs
- ASU 2020-01, Investments—Equity Securities (Topic 321), Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815), Clarifying the Interactions between Topic 321, Topic 323, and Topic 815
- ASU 2019-12, Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes

The following accounting standards are effective for non-public calendar year companies in 2021:

- ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities
- ASU 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
- ASU 2018-14, Compensation—Retirement Benefits—Defined Benefit Plans—General (Subtopic 715-20) Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans
- ASU 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
- ASU 2018-17, Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities
- ASU 2018-18, Collaborative Arrangements (Topic 808): Clarifying the Interaction between Topic 808 and Topic 606
- ASU 2019-02, Entertainment—Films—Other Assets—Film Costs (Subtopic 926-20) and Entertainment—Broadcasters—Intangibles—Goodwill and Other (Subtopic 920-350)

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- ASU 2019-04, Codification Improvements to Topic 326, Financial Instruments—Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments
- ASU 2019-10, Financial Instruments: Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates
- ASU 2020-03, Codification Improvements to Financial Instruments
- ASU 2020-05, Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities
- ASU 2021-01, Reference Rate Reform (Topic 848): Scope
- ASU 2021-02, Franchisors—Revenue from Contracts with Customers (Subtopic 952-606): Practical Expedient
- ASU 2021-03, Intangibles—Goodwill and Other (Topic 350): Accounting Alternative for Evaluating Triggering Events

In addition, certain other issued accounting standard updates can be adopted early.

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Our extensive knowledge of US GAAP, ICFR and SEC reporting skills has given us the ability to assist our clients with transactions that are not only multifaceted, but the capability to implement new or complex accounting standards. We have over 175 partners and employees in our Los Angeles, Orange County, San Diego, and New York City offices. Many of our clients are developed from direct referrals from the Big 4 accounting firms, speaking to the level of quality services we provide.

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