



Table of Contents

<u>Executive Summary</u>	<u>1</u>
<u>Accounting & Financial Reporting</u>	<u>2</u>
<u>Regulatory & Compliance</u>	<u>8</u>



INDUSTRY INSIGHTS



Executive Summary

Q4 2023

Key Insights

Dear Colleagues and Friends,

In this issue of Industry Insights, we discuss the latest accounting, financial reporting, and regulatory and compliance developments for the fourth quarter of 2023.

In our Accounting and Financial Reporting update section, we discuss the SEC's rulemaking updates on **(1) cybersecurity disclosures, (2) claw backs of incentive-based compensation, (3) insider trading plans rule amendments, and (4) SEC's comment letter trends**. We also provide an update on the SEC's share-repurchase disclosure rule that was adopted in May 2023.

Continuing with the Accounting and Financial Reporting update, we discuss the accounting standards recently issued by the FASB on **Segment Reporting, Disclosure Improvements, Accounting and Disclosure of Crypto Assets, and Improvements to income Tax Disclosures**. We also provide an overview and status of the FASB's current technical agenda.

As part of the Regulatory and Compliance update, we discuss **California Climate reporting requirements** addressed in three new rules: SB 253, SB 261, and AB 1305, the rules' effective dates and which entities are impacted by these rules, amongst other important updates regarding these rules.

Q4 2023

SEC's Cybersecurity Disclosure Rule

The SEC adopted New Regulation S-K Item 106 ("Cybersecurity Rule") in July 2023 impacting public entities with annual reporting requirements. The rule requires registrants to include:

- A description of their processes, if any, for assessing, identifying and managing material risks from cybersecurity threats.
- A description of whether and how any risks from cyber threats, including as a result of any previous cyber incidents, have materially impacted or are reasonably likely to materially impact the registrant including business strategy, results of operations or financial condition.
- Disclosure of governance in the registrant's annual report, including information about the board of directors' oversight of risks from cybersecurity threats and management's role and expertise in assessing and managing material risks from cybersecurity threat.

All registrants must provide such disclosures beginning with annual reports for fiscal years ending on or after December 15, 2023 on Forms 10-K or 20-F.

The rule also includes incident disclosure and filing requirements for cybersecurity incidents determined to be material. **Registrants are required to file an Item 1.05 Form 8-K about any material cybersecurity incidents generally within four business days of such determination.** The 8-K is required to disclose the nature, scope, and timing of the incident and the material impact or reasonably likely material impact on the registrant, including its financial condition and results of operations.

SEC's Clawbacks of Incentive-Based Compensation is Effective for 2023

The clawback of incentive-based compensation rule was finalized in October 2023 and registrants are required to adopt clawback policies by December 1, 2023 and file the newly adopted policies as an exhibit to their annual report and to provide other related disclosures. The rule directs national securities exchanges and associations to establish listing standards to require listed registrants to have policies for recovering (or clawback) erroneously awarded incentive-based compensation to current and former executive officers (as defined under Rule 10D-1) that was received during the three-year period preceding the date the issuer is required to prepare the accounting restatement. The rule is triggered when it is determined the registrant is required to prepare an accounting restatement that corrects an error in previously issued financial statements, including both "Big R" and "little r" restatements. For calendar year-end entities, new disclosures are required for December 31, 2023 Forms 10-K and 20-F.

SEC's Insider Trading Rule was Amended and is Effective for 2023

The SEC had recently proposed amendments to Insider Trading plans required disclosures. The rule is now final and is effective for registrants' first Form 10-Q, 10-K or proxy or information statement filing covering the first full fiscal period beginning on or after April 1, 2023. The amendments create new disclosure requirements that include:

- Quarterly disclosure by registrants regarding the use of Rule 10b5-1 plans and certain other written trading arrangements by a registrant's directors and officers for the trading of its securities;
- Annual disclosure of a registrant's insider trading policies and procedures;
- Certain tabular and narrative disclosures regarding awards of options close in time to the release of material nonpublic information and related policies and procedures;
- Tagging of the required disclosures; and
- A requirement that Form 4 and 5 filers indicate by checkbox that a reported transaction was intended to satisfy the affirmative defense conditions of Rule 10b5-1(c).

Effective Date of the Share Repurchase Disclosure Modernization Rule Postponed

The Share Repurchase Disclosure Modernization Rule was issued by the SEC in May 2023 and required registrants to disclose any share purchase, aggregated on a monthly basis, made by or on behalf of any affiliated purchaser in periodic reports (Form 10-K, 10Q, 20-F, or N-CSR). The rule would have been effective for domestic filers' first filing covering the first full quarter beginning or after October 1, 2023. However, in response to a lawsuit filed by the Chamber of Commerce, the US Court of Appeals for the Fifth Circuit found that the SEC "failed to conduct a proper cost-benefit analysis" of the rule and has directed the SEC to correct the defects by November 30, 2023. In light of the court's decision, the SEC issued an order postponing the effective date of the rule and the rule is pending further SEC action.

SEC Comment Letter Trends

The SEC staff focus in 2023 continues to be (1) Non-GAAP Disclosures, (2) MD&A, (3) Business combinations, (4) Segment reporting, (5) Revenue recognition and (6) Climate-related Disclosures.

The Non-GAAP comments are mostly focused on the following categories of comments: (1) reconciliation of the Non-GAAP measures from the most comparable GAAP financial measure, (2) exclusion of the normal or recurring cash operating expenses, and (3) use and applicability of individually tailored accounting principles.

The comment letters regarding the disclosures in the MD&A are focused mostly on the analysis of results of operations, critical accounting estimates, metrics used by management in assessing performance, and liquidity and capital resources, amongst other things.

The accounting for and disclosures related to a business combination has always been a focus area for the SEC staff. Highlights from comments include reasons for omitting certain disclosures required by ASC 805.

The SEC frequently asked how registrants identified their operating segments and how they aggregated them into reportable segments. The expectation is when a company has disclosed any significant acquisitions or dispositions, there will be changes to the reportable segments. Other comments related to segment reporting include measures of profit or loss used to report on each segment.

Revenue recognition continues to be a hot topic for the SEC for the past several years. In 2023, we have noted an increase in the number of comments related to this topic. The nature of the comments generally involve: identification of the performance obligations and explanation around why goods or services are distinct; determination of the standalone selling price, including the method and assumptions used to estimate the transaction price; determination of the variable consideration; and the method the company uses to recognize revenue.

When it comes to climate disclosures, while the SEC is set to finalize its final climate-related disclosures rule, they started to focus on the quality and adequacy of information registrants provide for their climate disclosures. The comments are focused on climate-related risks and opportunities and their impact on the financial condition and results of operations of the entity.



Other Important SEC Updates Regarding Statement of Cash Flows

During the most recent AICPA Conference that took place between December 4-6, 2023, SEC chief accountant Paul Munter expressed the importance of the statement of cash flows for all registrants. Mr. Munter provided feedback on the statement of cash flows along with issuance of a new public statement on this topic. As a result, the SEC will place more emphasis on the evaluation of errors in the cash flow statement from both qualitative and quantitative standpoint. Mr. Munter also reiterated that providing the Statement of cash flows under the direct method is preferable for the users of the financial statements and specifically to the investors.

FASB Requires Companies to Disclose Significant Segment Expenses (ASU 2023-07)

The new guidance applies to all public entities that are required to report segment information in accordance with topic 280. The ASU requires entities to disclose on an annual and interim basis, (1) significant segment expenses that are regularly provided to the chief operating decision maker (CODM) (2) disclose an amount for other segment items by reportable segment and a description of its composition which would equal the difference between segment revenue and significant segment expenses disclosed under (1) above, (3) disclose each reportable segment's profit and loss and assets currently required by Topic 280 in their annual disclosures, (4) report additional measures of segment profit if the CODM uses more than one measure of a segment's profit or loss in assessing segment performance, (5) disclose the title and position of the CODM and whether the CODM reviews more than one measure of segment profit or loss for decision making, (6) requires an entity with a single reportable segment to provide all disclosures required in the Update.

ASU 2023-07 is effective for all public entities for fiscal years beginning after December 15, 2023, and for interim periods beginning after December 15, 2024. Early adoption is permitted.

FASB Issues Guidance on Accounting and Disclosure of Crypto Assets (ASU 2023-08)

The FASB issued its final guidance on crypto assets, requiring companies to measure certain crypto assets held at fair value to reflect changes in the fair value in net income at each reporting period. The guidance also requires companies to report crypto assets separately from their other intangible assets on the balance sheet and report changes in fair value of those crypto assets separately from changes in the carrying value of other intangibles on their income statement.

With respect to cash flow classification, if the company received crypto assets as noncash consideration in the ordinary course of business and converted the crypto assets to cash immediately, it is required to classify those cash receipts as operating activities.

ASU 2023-08 is effective for fiscal years beginning after December 15, 2024, including interim periods within those fiscal years. Companies are required to provide interim and annual disclosures of the types and amounts of crypto assets they hold.

FASB Improves the Transparency and Effectiveness of Income Tax Disclosures (ASU 2023-09)

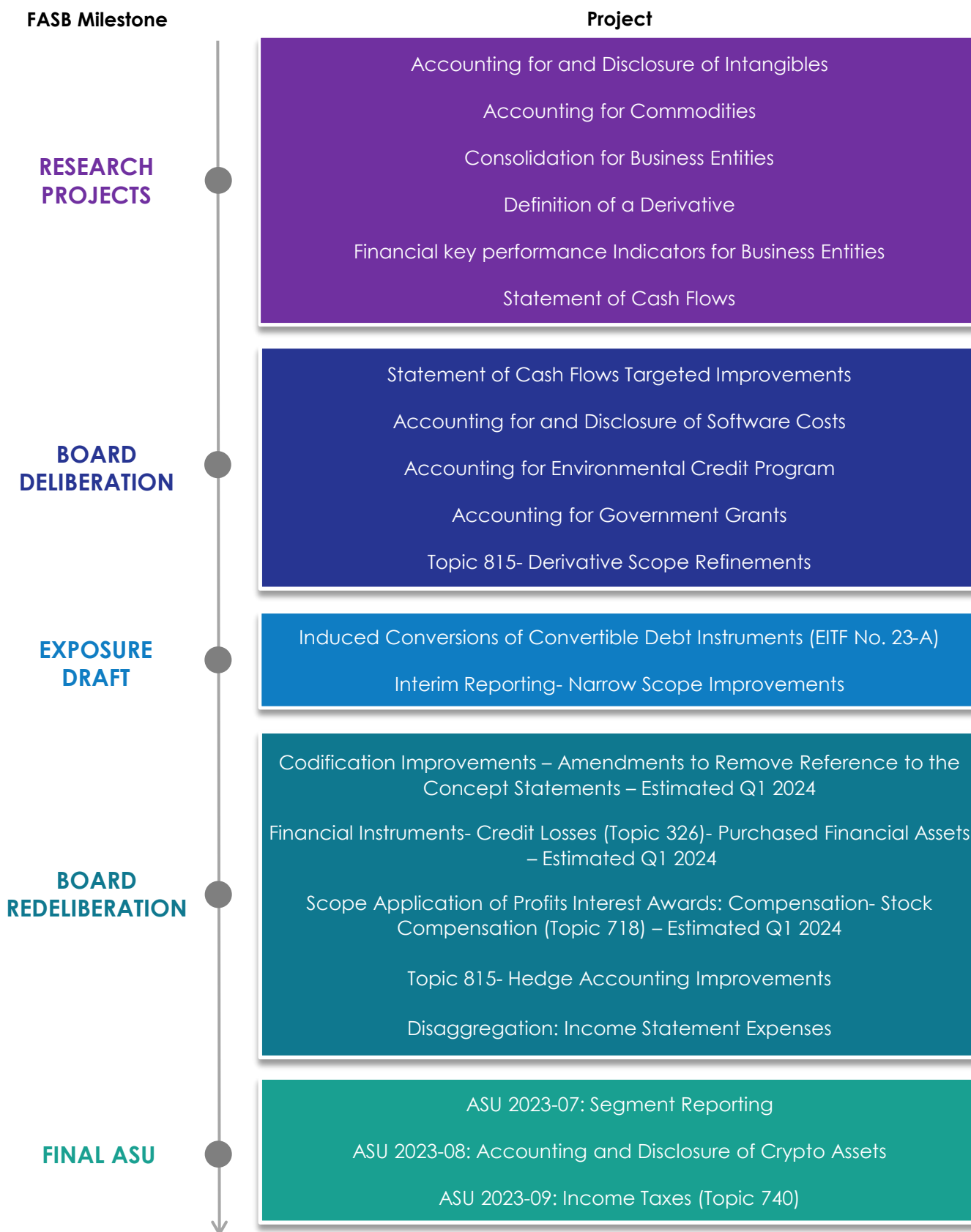
In the final rule issued on this topic, the FASB is requiring public business entities on an annual basis to disclose specific rate reconciliation categories in the rate reconciliation, along with other jurisdictional and qualitative disclosures, including significant reconciling items by nature, qualitative descriptions of the states and local jurisdictions that make up the majority (greater than 50 percent) of the effect of the state, and local income tax. For entities other than public business entities, categories of reconciling items and individual jurisdictions that result in a significant difference between the statutory tax rate and the effective tax rate.

The rule also requires all entities (both public and nonpublic) to provide, on a disaggregated basis, the federal, state, and foreign income taxes paid, along with the disaggregation of certain elements of income (loss) from continuing operations related to domestic, state and foreign taxes, and other changes to disclosures.

ASU 2023-09 is effective for public business entities for fiscal years beginning after December 15, 2024, and for entities other than public business entities for annual periods beginning after December 15, 2025.



FASB Technical Agenda^[1] as of January 8, 2024



[1] <https://www.fasb.org/technicalagenda>

Q4 2023

California Climate Disclosure Laws SB-253, SB-261, and AB-1305

On October 7, 2023, California Government passed into law two new climate disclosure bills that are expected to impact thousands of public and private entities.

SB-253, the Climate Corporate Data Accountability Act, requires entities with annual revenues in excess of \$1 billion to report annually on their direct emission of Greenhouse Gas (Scope 1 and Scope 2) starting in 2026, and indirect emissions (Scope 3) starting in 2027. A phased-in assurance will be required to be performed by independent assurance providers.

SB-261, The Climate-Related Financial Risk Act, requires entities with total revenues in excess of \$500 million to disclose 1) climate-related financial risks and 2) measures adopted to reduce and adapt to climate-related financial risk, in accordance with the recommended framework and disclosures of the Task Force on Climate-related Financial Disclosures (TCFD), biennially. Entities are required to make this report publicly available on their website on or before January 1, 2026.

In addition to the two new laws that will have the most impact on companies that “do business in California”, there is also another climate related California law, **AB-1305**. This law requires entities to disclose on any net zero emissions claims, carbon-neutral claims or any GHG emissions reduction claims that are significant, as well as any voluntary carbon offsets they have committed to purchase.

Regulatory
&
Compliance

Snapshot Summary of SB-253 and SB-261

	California Senate Bill 253 (SB 253) Climate Corporate Data Accountability Act	California Senate Bill 261 (SB 261) Greenhouse Gases: Climate-Related Financial Risk
Impacted Companies	<p><u>Public and non-public</u> US businesses with annual revenue over \$1 billion that do business in California</p> <p>No specified exemption for this reporting requirement</p>	<p><u>Public and non-public</u> US businesses with annual revenue over \$500 million that do business in California</p> <p>Insurance companies are exempt from this requirement</p>
Reporting Requirement	<p>Report Scope 1, Scope 2, and Scope 3 greenhouse gas emissions</p>	<p>Climate-related financial risk report that discloses:</p> <ol style="list-style-type: none"> Climate-related financial risks Measures adopted by the company to reduce and adapt to climate-related financial risk
Reporting Framework	<p>The Greenhouse Gas Protocol</p>	<p>The recommended framework and disclosures of the Task Force on Climate-related Financial Disclosures (TCFD)</p>
Effective Date	<p>Starting in 2026, report on FY2025 direct emissions (Scope 1 and Scope 2)</p> <p>Starting in 2027, report on FY2026 indirect emissions (Scope 3)</p>	<p>Entities to make this report publicly available on their website on or before January 1, 2026</p>
Reporting Frequency	<p>Annually</p>	<p>Biennially</p>
Assurance	<p>Phased-in independent assurance requirements, beginning with limited assurance</p>	<p>None</p>

Who is CNM?

Founded in 2003, CNM is recognized as one of the premier technical advisory firms in Southern California with Big 4 experience that provides the responsive customer service of a boutique firm. And we're a dynamic team that enlists all our energy to help transform the way your company does business – carefully evaluating your needs, simplifying your financial processes, and passionately solving problems in the most cost-effective way.

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 200 global professionals in our Los Angeles, Orange County, San Diego, New York City, and Kuala Lumpur 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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