Real estate accounting and reporting 2022

The impact of new standards and guidance for real estate companies and funds

December 2022

kpmg.com/us

As a leader in real estate financial reporting, KPMG LLP (KPMG) creates this report annually to assist real estate companies and funds with their financial accounting, regulatory, and compliance reporting requirements.

Following the tradition of this report, we provide key reminders for certain guidance including reminders on private entity adoption of the leases standard (Topic 842), equity method investments, simplification for income taxes, leases with variable lease payments, and convertible debt.

We also focus on reminders to consider given the current economic uncertainty, including the effect on impairment of nonfinancial assets, impairment testing, fair value analysis, and going concern reminders.

The report looks ahead to new standards and guidance, including LIBOR's wind down, amendments to troubled debt restructuring guidance, and fair value hedge accounting. Additionally, we discuss proposed changes from the SEC for the private funds industry, which include enhanced investor protections and additional disclosures relating to cybersecurity risk management. We address proposed guidance relating to the proportional amortization method election for tax credits. We also focus on proposed developments in environmental, social, and governance (ESG) disclosures, which would bring more enhanced disclosures relating to climate risks.

We are happy to discuss the financial reporting requirements related to your specific situations or objectives in more detail. We look forward to continuing to work with you to effectively navigate this dynamic accounting and regulatory environment as well as support your efforts to achieve your broader business objectives.

Thank you.

Greg Williams

National Sector Leader
Asset Management/Building, Construction, and Real Estate

KPMG LLP

Contents

1 – Accounting reminders – Effective in 2022 for private companies 4

It's here! – Private entities adopt the leases standard 4

Equity method investments 5

Policy election not to allocate consolidated income taxes 5

2 – Accounting reminders – Effective in 2022, or later for certain private companies 6

Disclosures for business entities receiving government assistance 6

Lessors – Certain leases with variable lease payments 6

Convertible debt and contracts in own equity 7

3 – Looking ahead to new standards and guidance 8

LIBOR's wind down has started 8

FASB amends Troubled Debt Restructuring (TDR) guidance and enhances disclosures 8

FASB expands fair value hedge accounting 9

4 – Proposed guidance and emerging matters 10

SEC proposes sweeping changes for the private funds industry 10

Proportional amortization method election 10

ESG developments 11

ESG reporting 11

New tax legislation 12

5 – Accounting reminders for the current environment 13

Impairment reminders 13

Going concern reminders 14

Lease accounting impacts 15

6 – How KPMG can help 16

1 Accounting reminders – Effective in 2022 for private companies

Reminders for certain new guidance previously effective for public companies and now effective January 1, 2022 for private calendar year-end companies.

It's here! – Private entities adopt the leases standard

Calendar year-end private entities were required to adopt Topic 842 on January 1, 2022. Private entities with noncalendar year-ends are required to adopt on the first day of their fiscal year beginning after January 1, 2022 (e.g., April 1, 2022 for a private entity with a March 31 year-end).

Below we highlight important disclosure, initial measurement, and other reminders to assist private entities in their transition efforts.

Disclosure requirements

Private entities that elect the modified retrospective transition option must include in the financial statements in the year of adoption all of their final lease disclosures under Topic 840. This includes the final Topic 840 disclosures of future operating and capital lease commitments prepared as of the last balance sheet before applying Topic 842 (e.g., December 31, 2021 for a calendar year-end private entity).

Initial measurement

Regardless of whether a lessee elects the package of practical expedients or only the "use-of-hindsight" practical expedient, lease liabilities for existing leases (i.e., leases that commence before the lessee's date of adoption) are measured at the present value of the sum of:

- The remaining "minimum rental payments" (as defined under Topic 840)
- Amounts probable of being owed by the lessee under a residual value guarantee.

The minimum rental payments for a lease under Topic 840 include those payments due over the accounting "lease term," which may extend beyond the noncancelable period of the lease.

A lessee that does not elect the use-of-hindsight practical expedient does not reassess the lease term when transitioning to Topic 842. The lessee continues to use the lease term determined under Topic 840 (assuming it was appropriately determined) when measuring the remaining minimum rental payments.

A lessee electing the use-of-hindsight practical expedient reassesses the lease term as of the initial application date under Topic 842. In doing so, the lessee considers all economic factors relevant to that assessment as of the effective date, including contract-based, asset-based, market-based, and entity-based factors.

Common implementation challenges

Private entities can benefit from considering the adoption lessons learned by public companies and prioritizing their efforts accordingly. Commonly identified implementation challenges include:

- Identifying all of the entity's leases, including embedded leases
- Abstracting the lease data necessary to account for leases under Topic 842 and make the required disclosures
- Determining the discount rate for lessee leases (which may be partially, or even substantially, mitigated for private entities that elect to use the "risk-free discount rate" practical expedient for most or all their leases).

KPMG

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. NDP398000 -1A

KPMG has several Topic 842 resources, including KPMG Handbook: Leases and a suite of Hot Topics that target common implementation challenges.

On page 6 of this report, we discuss newly effective guidance that requires lessors to classify leases with variable payments that do not depend on an index or rate as operating leases if another classification (i.e., sales-type or direct financing) would result in a commencement date selling loss (Day 1 loss).

Equity method investments

The Financial Accounting Standards Board (FASB) issued an accounting standard,[1] which clarifies the interactions between Accounting Standards Codification (ASC) 321, ASC 323, and ASC 815. The new guidance addresses accounting for the transition into and out of the equity method.

ASC 321 provides a measurement alternative that permits certain equity investments without readily determinable fair values to be measured at cost, minus impairment (if any), and subsequently remeasured to fair value using prices from observable transactions in identical or similar securities of the same issuer. Equity securities initially within the scope of ASC 321 may subsequently fall within the scope of ASC 323 and vice versa. The Accounting Standards Update (ASU) requires that when transitioning in to or out of the measurement alternative under ASC 321, an investor must remeasure its equity securities to fair value both immediately before, and on discontinuation of, the equity method of accounting based on the observable transaction that triggered the change in applicability of the equity method. If application, or discontinuation, of the equity method of accounting is not the result of an observable transaction that would require remeasurement of equity securities within the scope of ASC 321 (e.g., because the investor obtained significant influence by means other than the acquisition of an additional equity interest in the investee), then there is no remeasurement of those securities upon acquisition, or discontinuation, of equity method accounting.

This guidance was applicable for public business entities for annual and interim periods in fiscal years beginning after December 15, 2020. For other entities, the guidance became effective for annual and interim periods in fiscal years beginning after December 15, 2021.

Policy election not to allocate consolidated income taxes

The FASB issued guidance[2] to simplify accounting for income taxes, change the accounting for certain income tax transactions, and make minor improvements to the Codification. Among other things, the ASU provides guidance to evaluate whether a step up in tax basis of goodwill relates to a previous business combination or should be accounted for as a separate transaction.

The ASU also provides a policy election to not allocate any portion of the consolidated amount of current and deferred tax expense to a legal entity in its separate financial statements if the legal entity is not itself subject to tax and is disregarded by the taxing authority. However, an entity may elect to do so as long as the legal entity is not a partnership (or other pass-through entity that is not wholly owned).

Legacy accounting guidance does not specify whether the requirement to allocate current and deferred income taxes to members that are included in a consolidated tax return applies to entities that are not subject to tax—e.g., single-member LLCs. We understand that some entities are currently allocating current and deferred income taxes to legal entities that will meet the ASU's conditions to no longer require allocation. We believe an entity may change its current policy about allocation without establishing preferability because the ASU sufficiently supports making the change.

The guidance was effective for calendar year-end public business entities on January 1, 2021 and became effective for other entities on January 1, 2022.

---

[1] FASB ASU No. 2020-01, *Clarifying the interactions between Topic 321, Topic 323, and Topic 815*

[2] FASB ASU No. 2019-12, *Simplifying the Accounting for Income Taxes*

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. NDP398000 -1A

2 Accounting reminders – Effective in 2022, or later for certain private companies

Reminders for certain new guidance effective January 1, 2022, for public calendar year-end companies and effective January 1, 2023 or later for private calendar year-end companies.

Disclosures for business entities receiving government assistance

In November 2021, the Financial Accounting Standards Board (FASB), issued guidance[3] that created Topic 832, *Government Assistance*, which requires business entities to disclose information about certain government assistance that they receive. Not-for-profit entities and employee benefit plans are automatically exempt from the new disclosure requirements. Entities must comply with the new disclosure requirements if they account for transactions with government entities under the (1) contribution model (e.g., Subtopic 958-605) or (2) grant model (e.g., IAS 20) by analogy.

The Topic 832 disclosure requirements include:

- The nature of the transactions and the related accounting policy used
- The line items on the balance sheet and income statement that are affected and the amounts applicable to each financial statement line item
- Significant terms and conditions of the transactions.

Entities should consider all transactions, both foreign and domestic, that involve government entities. Even if an entity considers an assistance payment immaterial, the payment may have to be disclosed if the entity receives similar payments and the payments in the aggregate are material.

The guidance became effective for all entities in fiscal years beginning after December 15, 2021.

Lessors – Certain leases with variable lease payments

In July 2021, guidance[4] was issued that requires lessors to classify leases with variable payments that do not depend on an index rate as operating leases if another classification (i.e, sales-type or direct financing) would result in a commencement date selling loss (Day 1 loss).

Prior to this standard becoming effective, a sales-type or direct financing lease with variable lease payments could give rise to a Day 1 loss. This is because the net investment in the lease excludes expected variable lease payments, and, therefore, the initial net investment may be less than the carrying amount of the underlying asset being derecognized at lease commencement. That difference gives rise to the Day 1 loss. After adopting this ASU, these leases will be classified as operating leases. Therefore, the lessor will neither derecognize the underlying asset nor record a Day 1 loss. In addition, variable lease revenue earned and recognized over the lease term will be partially offset in net income each period of the lease term by the depreciation expense of the underlying asset instead of being recognized at a 100 percent margin.

The FASB believes that this accounting better reflects the economics of these lease arrangements and more closely aligns lessors' Topic 842 accounting for these leases with how they were accounted for under legacy U.S. GAAP (Topic 840), consistent with the Board's original intent not to substantially change lessors' accounting.

---

[3] FASB ASU No. 2021-10, *Disclosures by Business Entities about Government Assistance*

[4] FASB ASU No. 2021-05, Leases (Topic 842): *Lessors – Certain Leases with Variable Lease Payments*

KPMG

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. NDP398000 -1A

The guidance became effective for annual periods for all entities in fiscal years beginning after December 15, 2021. The guidance became effective for interim periods for public business entities in fiscal years beginning after December 15, 2021, and will become effective for interim periods for all other entities in fiscal years beginning after December 15, 2022.

Convertible debt and contracts in own equity

In August 2020, the FASB issued guidance[5] that reduces the number of accounting models for convertible instruments and allows more freestanding contracts to qualify for equity classification.

The ASU simplifies the accounting for convertible instruments. The ASU eliminates the beneficial conversion feature and cash conversion models, reducing the number of models to account for convertible instruments. This simplification will likely result in (1) more convertible instruments being accounted for as a single unit and (2) lower interest expense for convertible debt instruments. The ASU also makes targeted changes to the disclosure requirements for convertible instruments.

The ASU simplifies the accounting for contracts in an entity's own equity. The ASU removes some of the conditions that currently preclude a freestanding contract from being classified in equity (or preclude an embedded derivative from meeting the derivative scope exception). The ASU also clarifies other conditions that are difficult to apply or are internally inconsistent.

The ASU simplifies the earnings per share (EPS) calculation for convertible instruments, including assuming share settlement when there is a cash or share settlement option. The share settlement presumption will result in a lower diluted EPS.

The new guidance is effective for Securities and Exchange Commission (SEC) filers that are not smaller reporting companies for annual and interim periods in fiscal years beginning after December 15, 2021. For other entities, it is effective for annual and interim periods in fiscal years beginning after December 15, 2023. Early adoption is permitted, including interim periods within those fiscal years. An entity should adopt the guidance at the beginning of its annual fiscal year.

[5] FASB ASU No. 2020-06, *Accounting for Convertible Instruments and Contracts in an Entity's Own Equity*

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. NDP398000 -1A

3 Looking ahead to new standards and guidance

LIBOR's wind down has started

As of December 31, 2021, several LIBOR settings were discontinued (see below), but some of the settings most widely used in the U.S. will continue to be published until June 30, 2023. Topic 848 (reference rate reform) provides companies with optional expedients to ease the potential accounting burden associated with transitioning away from LIBOR. Topic 848's expedients are generally unavailable after the Topic's December 31, 2022 sunset date. The FASB has issued a proposed ASU that would defer the sunset date by two years to December 31, 2024. The deferral would be effective immediately on issuance of a final ASU.

Action by IBA[6]	Relevant settings
Ceased publishing certain LIBOR settings after December 31, 2021.	1-week and 2-month USD LIBOR settings (these are two lesser-used USD LIBOR settings) and all GBP, EUR, CHF, and JPY LIBOR settings.
Began publishing "synthetic" LIBOR1 for certain settings, effective from January 1, 2022; IBA is required to publish these settings through 2022.	1-, 3-, and 6-month, GBP and JPY LIBOR.
Announced in March 2021 that it intends to stop publishing the remaining LIBOR settings after June 30, 2023.	Overnight, 1-month, 3-month, 6-month, and 12-month USD LIBOR settings; these are the major USD LIBOR settings.

FASB amends Troubled Debt Restructuring (TDR) guidance and enhances disclosures

For entities that have adopted the credit impairment standard (Topic 326), new guidance[7] makes various changes to U.S. GAAP, primarily relating to loan modifications and disclosures. The new guidance:

- Eliminates separate recognition and measurement guidance for troubled debt restructurings, so creditors will apply the same guidance to all modifications when determining whether a modification results in a new receivable or a continuation of an existing receivable
- Requires expected credit losses measured under a discounted cash flow (DCF) method to be determined using an effective interest rate based on the receivable's modified (not original) contractual terms for all modified receivables; a DCF (or reconcilable) method is no longer required for any modified receivables
- Enhances disclosures by creditors for modifications of receivables from debtors experiencing financial difficulty in the form of principal forgiveness, an interest rate reduction, an other-than-insignificant payment delay, or a term extension

---

[6] ICE Benchmark Administration Limited (IBA, LIBOR's administrator)

[7] FASB ASU No. 2022-02, *Troubled Debt Restructurings and Vintage Disclosures*

KPMG

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. NDP398000 -1A

- Augments existing disclosures by requiring creditors that are public business entities to disclose current-period gross write-offs by year of origination (i.e., the vintage year) for financing receivables and net investments in leases.

The new guidance is applied prospectively to modifications and write-offs beginning the first day of the fiscal year of adoption. However, a creditor may elect to adopt on a modified retrospective basis the effect on the allowance for credit losses related to the ASU's elimination of the TDR recognition and measurement guidance.

For entities that have adopted Topic 326, the new guidance is effective for annual and interim periods for fiscal years beginning after December 15, 2022. For all other entities, the new guidance is effective for annual and interim periods for fiscal years beginning after December 15, 2022, consistent with when the entity first applies Topic 326.

Early adoption is permitted for an entity that has adopted Topic 326 in any interim period as of the beginning of the fiscal year that includes the interim period. An entity may elect to early adopt the amendments related to receivable modifications separately from the amendments related to vintage disclosures.

FASB expands fair value hedge accounting

New guidance[8] establishes the portfolio-layer method, which expands an entity's ability to achieve fair value hedge accounting for hedges of financial assets in a closed portfolio. The primary provisions of the new guidance:

- Allow nonprepayable financial assets to be included in the closed portfolio
- Expand the current single-layer model to allow multiple hedged layers of a single closed portfolio
- Clarify that fair value basis adjustments in an existing portfolio-layer method hedge are maintained at the closed portfolio-level (i.e., not allocated to individual assets)
- Prohibit an entity from considering fair value basis adjustments related to a portfolio-layer method hedge when estimating credit losses
- Address how an entity accounts for fair value basis adjustments when discontinuing a portfolio-layer method hedge
- Allow the reclassification of held-to-maturity debt securities to available for sale within 30 days of the date of adoption, if certain criteria are met.

Portfolio-layer method hedging allows entities to achieve fair value hedge accounting for a greater proportion of the interest rate risk inherent in a closed portfolio of financial assets. Entities that are economically hedging closed portfolios as part of their risk management strategy should consider whether those economic hedges would qualify for hedge accounting under this guidance.

For public business entities, the new guidance is effective for annual and interim periods in fiscal years beginning after December 15, 2022. For all other entities, it is effective for annual and interim periods in fiscal years beginning after December 15, 2023. Early adoption is permitted on any date on or after the issuance of the guidance for any entity that has adopted the amendments in ASU 2017-12.

[8] FASB ASU No. 2022-01, *Fair Value Hedging – Portfolio Layer Method*

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. NDP398000 -1A

4 Proposed guidance and emerging matters

SEC proposes sweeping changes for the private funds industry

The Securities and Exchange Commission (SEC) has proposed a series of new and amended rules concerning regulating private fund investment advisers and the funds that they advise. The proposals intend to better protect private fund investors by increasing transparency, competition, and efficiency in a rapidly growing market that now represents about $18 trillion. Collectively, these proposals would have a significant effect on the compliance efforts of private funds and their registered investment advisers and would enhance the SEC's oversight of those entities.

Enhanced investor protections

The SEC issued proposed rules and amendments to enhance the regulation of private fund advisers. Among the proposals, registered private fund advisers would be required to:

- Provide investors with quarterly statements detailing information about fund performance, fees, and expenses
- Obtain an annual audit for each private fund that they advise and require the fund's auditor to notify the SEC upon certain events
- Obtain a fairness opinion from an independent opinion provider in connection with an adviser-led secondary transaction.

In addition, the proposals would prohibit all private fund advisers, including those that are not registered with the SEC, from:

- Engaging in certain activities and practices that the SEC considers to be contrary to the public interest and protecting investors
- Providing certain forms of preferential treatment that have a material negative effect on other investors while prohibiting all other types of preferential treatment unless disclosed to current and prospective investors.

Further, the proposals would require all registered fund advisers, including those that do not advise private funds, to document the annual review of their compliance policies and procedures in writing.

Cybersecurity risk management

The SEC has issued a proposed rule that would enhance and standardize disclosures regarding cybersecurity risk management, strategy, governance, and incident reporting for registrants. The proposals aim to provide more consistent and decision-useful information so that investors can better evaluate a registrant's exposure to cybersecurity risks and incidents and provide strategies to mitigate them.

Of note, the proposals would increase the prominence and timeliness of reporting material cybersecurity incidents on Form 8-K. They would also require enhanced disclosures about:

- Cybersecurity incidents in periodic reports
- Cybersecurity risk management policies and strategy
- Cybersecurity oversight by the board of directors and the directors' expertise.

Currently, there are no disclosure requirements in Regulations S-K or S-X that explicitly refer to cybersecurity risks or incidents. While the SEC has acknowledged that disclosures of material cybersecurity incidents, risk management, and governance laws have improved in recent years, disclosure practices are inconsistent and lack sufficient information for investors.

Proportional amortization method election

The FASB has issued a proposed ASU that would allow companies to apply the proportional amortization method (PAM) to all qualifying investments, regardless of the type of tax credit program. Companies would be allowed to elect the PAM for qualifying investments based on the tax credit program.

KPMG

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. NDP398000 -1A

The proposal would clarify that when evaluating the PAM's "qualification criteria," companies would:

- Assess whether substantially all of an investment's projected benefits are from tax credits and other tax benefits on a discounted basis using a discount rate consistent with the investor's cash flow assumptions
- Treat refundable tax credits as nontax benefits
- Include all tax benefits, refundable tax credits, and nontax cash flows in the identification of total projected benefits
- Assess "significant influence" in relation to the operations of the underlying project.

The proposals would also amend the disclosure requirements that apply to investments in tax credit programs.

PAM is an alternative to either the cost or equity method of accounting, and its scope is currently limited to investments in qualified affordable housing projects made through limited liability entities.

ESG developments

In March 2022, the SEC proposed climate rules that are intended to provide more consistent, comparable, and reliable information so that investors can better evaluate the impact of climate-related matters on an issuer. Specifically, the proposal would require new disclosures in the annual report (Form 10-K or 20-F) or registration statements and in the financial statements.

Climate risk

The proposal would require certain disclosures in a new note to the financial statements, including financial impact and expenditure metrics and information about the effect of climate risks on financial estimates and assumptions. These disclosures would be in the scope of the registrant's internal control over financial reporting and subject to an audit.

The proposal would also require additional climate-related disclosures outside of the financial statements in their own section (or incorporated by reference) in the annual report or registration statement, including:

- Disclosures about Scope 1 and 2 Greenhouse Gas (GHG) emissions, which would be subject to assurance—limited and then reasonable assurance—for accelerated and large filers; disclosures about Scope 3 GHG emissions would be required only if material, or if the registrant has included Scope 3 in a GHG emissions reduction target or goals; smaller reporting companies would be exempt
- Disclosures that broadly align with the framework of the Task Force on Climate-related Financial Disclosures (TCFD) and fall under the broad categories of governance, strategy, and risk management.

Funds and investment advisers

The proposals target funds and investment advisers and are intended to provide (1) preparers with consistent standards for ESG disclosures and (2) investors with more certainty about the nature of a fund.

- **ESG Enhanced Disclosure Rule.** The proposals would identify three types of ESG funds with the aim of scaling disclosures depending on the significance of ESG factors to the fund's strategy. It would impact the prospectus, annual reports, and regulatory reporting.
- **Names Rule.** Proposed amendments to the "Names Rule" under the Investment Company Act of 1940 would require at least 80 percent of the fund's asset value to be invested according to what the fund's name suggests (e.g., social impact, green). In addition, in measuring asset value, derivatives would be measured at their notional amount.

ESG reporting

For the latest KPMG guidance and articles on ESG for financial reporting professionals, please visit our portal.

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. NDP398000 -1A

New tax legislation

The Inflation Reduction Act (IRA) of 2022 and the CHIPS and Science Act of 2022 (CHIPS) were signed into law by President Biden on August 16 and August 9, respectively.

The IRA introduces a new 15 percent corporate alternative minimum tax (Corporate AMT) and includes a substantial package of energy- and climate-related provisions, among other revenue raisers and incentives. CHIPS adds a one-time investment tax credit equal to 25 percent of a company's investment facilities that manufacture semiconductors or semiconductor manufacturing equipment.

The new laws also introduce mechanisms for monetizing some credits that are novel to U.S. tax law, including elections for "direct pay" and third-party transfer. The IRA also allows for increased and bonus credits if a company meets certain criteria.

Accounting impacts

Although no changes have been made to the U.S. federal corporate statutory tax rates, several provisions in the new laws may affect companies' forecasts of future income tax liabilities and the realizability of deferred tax assets.

Considerations for preparers include the following.

- **15 percent Corporate AMT.** Companies should account for the incremental tax owed under the Corporate AMT as it is incurred and continue to measure their deferred taxes at regular tax rates—at enactment and going forward. The Corporate AMT is effective for tax years beginning after December 31, 2022.
- **1 percent excise tax on stock repurchases.** The excise tax is levied on a non-income-based measure and is therefore not in the scope of Topic 740 (income taxes).
- **New options for monetizing certain tax credits.** Companies in the energy space may elect a transferability election through which they can sell certain tax credits to third parties. In addition, both the IRA and CHIPS introduce a direct pay mechanism for certain credits and certain taxpayers under which the credits are considered a direct payment of tax and are refundable. The accounting for these credits may depend on whether (1) are dependent on a company's taxable income or income tax liability and (2) they are transferable.

Certain refundable credits will be viewed like government grants. Because U.S. GAAP does not currently have specific guidance for businesses on how to account for government grants, many companies might analogize to IAS 20 to account for them. Other nonrefundable and transferrable credits may be in the scope of Topic 740 and require companies to make several policy elections.

KPMG

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. NDP398000 -1A

5 Accounting reminders for the current environment

The past several months have seen threats of a recession, increasing inflation, declining share prices, and rising interest rates, all of which have created economic uncertainty.

Although there has been much focus on the economic impact of these trends and events, the accounting impacts, including the effect on impairment of nonfinancial assets, cannot be overlooked. Do these economic trends and events represent triggering events for impairment testing? Do they affect a fair value analysis? Do they impact the ability of a company to continue as a going concern?

Impairment reminders

Impairment of long-lived assets (e.g. real estate assets; property, plant and equipment; lease right-of-use assets) is entirely trigger-based. These assets are tested for impairment when one or more events or circumstances indicate that the carrying amount of the long-lived asset group may not be recoverable.

A company may consider adjusting the projected cash flows used in not only its fair value estimates, but also its recoverability test. The cash flows are updated for known or expected events, such as the loss of a significant tenant or a more general reduction in demand, or increase in costs. In addition, changes in management's plans or the company's ability to hold an asset or asset group may alter the period used for recoverability – i.e. the length of cash flows projected. In all cases, the projected cash flows used for the recoverability test need to be consistent with the information the company uses for both internal planning and external communication.

A sustained decline in share price may also be indicative of other underlying facts and circumstances potentially affecting the recoverability of long-lived assets. Although Topic 360 does not mention market capitalization and share price trends as potential triggering events, the relevance of the underlying factors driving the decline in share prices should not be ignored. For example, a decline in share prices may signal weakening demand for a product, resulting in reduced cash inflows and potential impairment for an asset group.

If a company has determined that the carrying amount of an asset group is not recoverable, then a Step 2 fair value test is performed to quantify the impairment. The factors relevant to an indefinite-lived intangible or a reporting unit's fair value test for goodwill impairment purposes (e.g. the effect of discount rates) may also be relevant to a long-lived asset group's fair value test.

A lessee's right-of-use (ROU) assets may be impaired if the asset groups to which they belong are impaired. One or more of the aforementioned economic and financial markets effects may trigger a requirement for the lessee to assess one or more of its asset groups that includes an ROU asset for impairment under Topic 360. Similarly, lessors may find that some of their underlying assets held for lease are impaired if lessee demand for those assets significantly decreases or rental rates decline precipitously.

A public company should disclose the potential for material impairment charges even if it has determined that no impairment charge is necessary for the current reporting period. These disclosures generally would be expected to be disclosed in periods in advance of the charge.

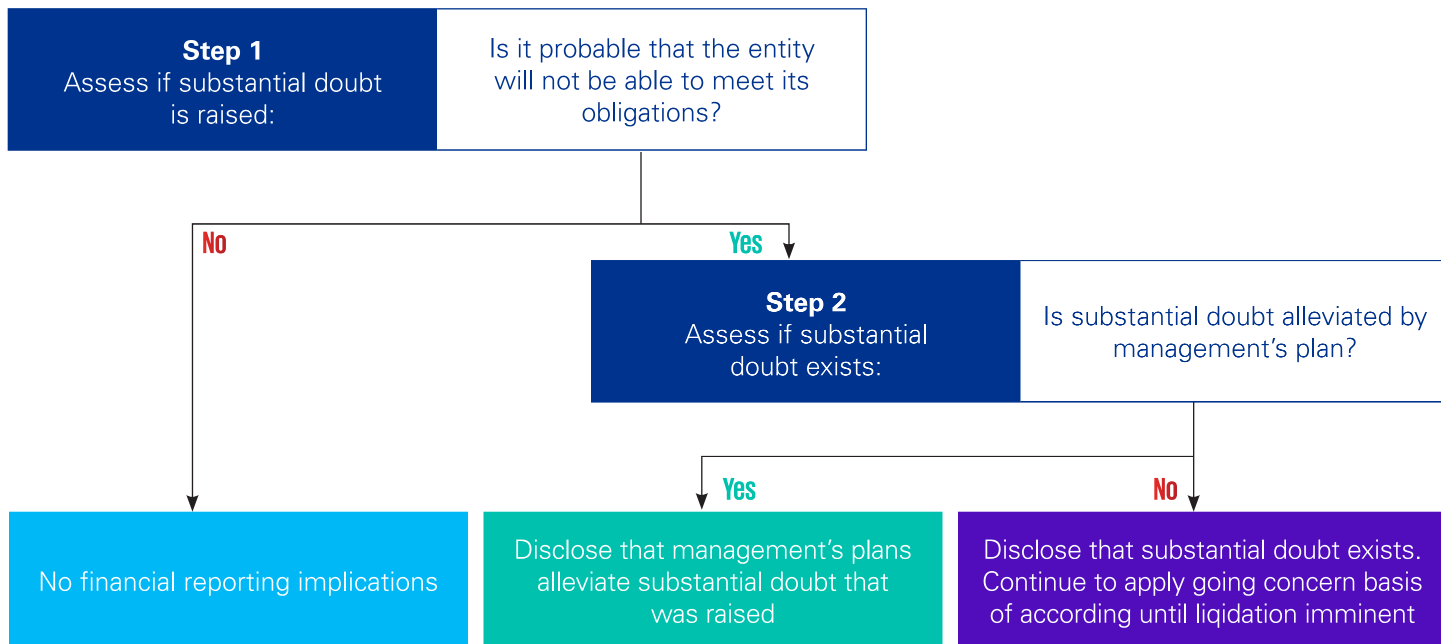
In addition, Topic 275 (risks and uncertainties) requires that companies disclose in their financial statements events or circumstances that could significantly affect the amounts that are reported in the financial statements.

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. NDP398000 -1A

Going concern reminders

To be a going concern, a company must have the ability to meet its obligations as they come due within one year after the financial statements are issued (available to be issued) – i.e. the look-forward period. Management has a responsibility to determine whether there are conditions and events that raise 'substantial doubt' about the company's ability to continue as a going concern.

The following diagram represents how this two-step assessment is conducted.



For many companies, a detailed going concern analysis may not have been necessary previously – historically profitable businesses, ready access to financial resources and no significant short-term obligations; however, these quantitative and qualitative factors may be changing as a result of the current environment.

A forecasted covenant violation, within or across interim periods in the look-forward period, may indicate a condition or event that raises substantial doubt about the entity's ability to continue as a going concern (Step 1). This would be the case if the covenant breach accelerates the debt maturity and the company does not have sufficient liquidity to satisfy the debt, including any additional cross-default violations from other obligations.

If substantial doubt is raised about the company's ability to continue as a going concern, the following disclosure is required in the financial statements:

- Conditions and events that raised substantial doubt;
- Management's evaluation of the significance of those conditions or events in relation to the company's ability to meet its obligations; and
- Management's plans that alleviated (i.e. eliminated) or are intended to alleviate (i.e. have not yet eliminated) the substantial doubt.

If substantial doubt exists, this fact should be explicitly disclosed. If substantial doubt does not exist, we believe the term 'substantial doubt' need not be used. The company can apply judgment as to the appropriate placement of the required information in the notes.

While the look-forward period is one year, it may be appropriate to provide additional disclosure about the potential effect of known conditions and events that may occur beyond one year. Those known conditions and events are often required to be disclosed in accordance with other U.S. GAAP requirements (e.g., loss contingencies, risk and uncertainties, debt) or SEC rules and regulations.

KPMG

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. NDP398000 -1A

Lease accounting impacts

A lessee's incremental borrowing rate, typically used by lessees as the 'discount rate for the lease', may be affected if interest rates significantly change (e.g. due to interest rate hikes) or its borrowing costs otherwise change (e.g. because of changes in credit rating).

An incremental borrowing rate determined during the current environment may appear anomalous to past incremental borrowing rates or what the lessee forecasts its incremental borrowing rate to be in the future. Despite that, we believe it is inappropriate to attempt to 'normalize' an incremental borrowing rate with adjustments the lessee would not otherwise make but for current economic conditions.

Multiple aspects of Topic 842 lease accounting also depend on fair value (e.g. of underlying assets and ROU assets). The fair value of the underlying asset affects lease classification for both lessees and lessors and the accounting for sale-leaseback transactions. The fair value of an ROU asset affects whether and how much impairment is recognized on an ROU asset. Fair values may be affected by current economic events.

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. NDP398000 -1A

6 How KPMG can help

ESG as an asset – Preparing your portfolio for the ESG future. Asset managers can stay ahead of the ESG curve by using data to demonstrate how differentiated financial returns and impact value can coexist. Our professionals outline the steps organizations should take to determine what ESG data is decision-critical and invest in its integrity.

KPMG IMPACT helps your business create a more sustainable future while driving measurable growth today. Our extensive services and capabilities focus on key ESG themes with a wide range of data-driven solutions, technology tools, and deep industry experience to navigate and simplify the complexities of every stage of your ESG journey.

KPMG ESG Assurance helps your journey to assured ESG reporting: establish your ESG reporting strategy; assess your company's readiness for reporting; design and implement a roadmap; sustain with continuous monitoring and testwork; and finally, be ready to provide your stakeholders with rigorous and timely ESG reporting.

KPMG

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. NDP398000 -1A

Contact us

For the latest KPMG perspectives on the real estate industry and to connect with us, please visit our industry portal.

Authors

Jessica Garaffa
T: 203-406-8048
E: jgaraffa@kpmg.com

Daniel O'Connor
T: 212-954-8480
E: dpoconnor@kpmg.com

National Sector Leader

Greg Williams
Asset Management/ Building, Construction, and Real Estate
T: 214-840-2425
E: gregorylwilliams@kpmg.com

Midatlantic

Tom Gerth
T: 703-286-6566
E: tgerth@kpmg.com

Midwest

Tony Circolone
T: 312-665-2210
E: acircolone@kpmg.com

Southeast

Jeff Podziewski
T: 704-335-5391
E: jpodziewski@kpmg.com

Jeffrey Wager
T: 704-370-4362
E: jwager@kpmg.com

Southwest

Troy Butts
T: 214-840-2107
E: tbutts@kpmg.com

Pacific Northwest

Roger Power
T: 415-963-5410
E: rjpower@kpmg.com

Pacific Southwest

Roger Yang
T: 213-630-8080
E: rogerlyang@kpmg.com

Northeast

Peter Bloomfield
T: 617-988-1173
E: pbloomfield@kpmg.com

David Kaplan
T: 212-954-7930
E: djkaplan@kpmg.com

Robert Fraher
T: 212-954-6979
E: rfraher@kpmg.com

ESG Services

Ruth Tang
T: 212-909-5083
E: ruthtang@kpmg.com

Ryan Swedalla
T: 212-954-3549
E: rswedalla@kpmg.com

Shruti Shah
T: 973-912-6316
E: skshah@kpmg.com

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

kpmg.com/socialmedia

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.
NDP398000 -1A