KPMG

Hot Topic: Russia-Ukraine war

Accounting and financial reporting impacts

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This Hot Topic highlights potential accounting and financial reporting issues created by the war and related economic sanctions.

Background

Russia's invasion of Ukraine and other nations' responses to the ensuing Russia-Ukraine war (e.g. in the form of sanctions on the Russian government and companies) may have a financial reporting impact on companies reporting under US GAAP. While the effects of the war and related economic sanctions are unpredictable, they obviously will affect companies with operations in Ukraine or Russia. For example, a company's Ukrainian facilities may be damaged or destroyed, while facilities in Ukraine or Russia may need to be indefinitely idled or abandoned. Other companies may be affected if they have significant customers or suppliers in those countries, while financial institutions that hold Russian or Ukrainian sovereign debt may see those investments adversely affected. Lastly, a wide cross-section of companies may be affected by disruptions in pricing and/or supply of energy and other commodities, and by other downstream effects.

This Hot Topic provides reminders (not meant to be all inclusive) about some of the potential impacts that the war and related economic sanctions may have on companies. These impacts are not limited to the current reporting period.

Status of reporting	Immediate focus
Past reporting period for which financial statements have not yet been issued	Subsequent events
Current (and future) reporting period(s)	All issues

Subsequent events

Events occurring after the balance sheet date but before the financial statements are issued (or available to be issued for non-SEC filers) require disclosure or possibly recognition. The Russia-Ukraine war is a subsequent event for companies that had not yet issued their financial statements on February 24, 2022. Many events related to the war, such as the imposition of economic sanctions against Russia and the destruction of property in Ukraine, are also subsequent events.

Subsequent events are either ‘recognized’ or ‘nonrecognized’. Recognized subsequent events provide additional evidence about conditions existing at the balance sheet date. The effects of such events must be recognized in the financial statements not yet issued. In contrast, nonrecognized subsequent events provide evidence of conditions that did not exist at the balance sheet date. The effects of such events on the financial statements not yet issued must be disclosed, but are not recognized, in those financial statements. [855-10-25-1, 25-3]

Nonrecognized subsequent events. For December 31, 2021 financial statements, the war and related events likely are nonrecognized subsequent events because they do not relate to conditions that existed at the balance sheet date. For example, companies may experience damage to physical assets located in combat zones, but any related impairment losses are recognized in the reporting period in which they occur (either the current period or a future period). However, if any damage occurred after December 31, 2021 but before the December 31, 2021 financial statements were issued (or available to be issued), the effects of that damage must be disclosed in those financial statements.

Because these events have far reaching consequences beyond Russia and Ukraine and are rapidly evolving, the later the financial statements are issued, the more pervasive and detailed these disclosures will need to be. Each company will need to evaluate the relevant facts and circumstances to determine the extent of required disclosures. Considering all available facts (e.g. market prices) and the effect of such facts on management’s estimates through the date the financial statements are issued (available to be issued) may present operational challenges and require judgment in complex estimate models, given the rapidly changing situation.

Recognized subsequent events. There may be existing conditions at the balance sheet date further impacted by the war and related events, such that recognition in the December 31, 2021 financial statements may be required. A company should evaluate the facts and circumstances to determine whether the subsequent events provide additional evidence about existing conditions at the balance sheet date.

Later periods. For reporting periods ending after February 24, 2022, the war is a current period event that will require ongoing evaluation to determine the extent to which developments after the respective reporting date should be recognized or disclosed in that reporting period.

Subsequent events disclosure considerations

Quantitative disclosure of the estimated financial effects of the subsequent event(s) is required if it can be made. This estimate is to be based on the facts available at the date the financial statements are issued (available to be issued) and should avoid general forward looking statements. For example, it would not be appropriate to disclose that: “We expect the fair value of our investment to recover in the near future.” But a company could say: “The fair value of our investment as of this date has dropped by xx% since [reporting date]. We are uncertain if those values will rebound in the near future.”

Companies need to separately assess the events that have occurred as a *series* related to the war and not focus exclusively on a single event – e.g. the war itself, specific international economic sanctions announcements. Each company may be affected differently by each event and should adapt its disclosures accordingly.

Risks and uncertainties

Topic 275 requires disclosure of risks and uncertainties that could significantly affect the amounts reported in financial statements in the near term. The war and related events may require companies to add or revise risks and uncertainties disclosures to discuss significant near term effects related to these events. These disclosures are incremental to the disclosure requirements about going concern (Subtopic 205-40) and include disclosures addressing certain estimates and significant concentrations in the company's operations. [275-10-05-02]

Disclosure areas	Disclosure considerations
Estimates	— New characteristics of uncertainty in revenue forecasts, sourcing and workforce availability, credit ratings, etc. — Updated estimates based on volatility in stock and commodity prices, interest and currency exchange rates
Vulnerability from concentrations	— Volume of business transacted with a particular customer, supplier, lender, grantor or contributor — Revenue from particular products, services or fund-raising events — Available sources of supply of materials, labor or services, or of licenses or other rights used in the company's operations — Market or geographic area in which a company conducts its operations
Risks and uncertainties – disclosures	— New risks and uncertainties arising from the war, and how the company plans to address these risks — Possible need to repeat and update those disclosures at each interim period in 2022 to provide transparency and fairness of presentation

Unusual items

The financial effects of material events or transactions considered to be unusual or infrequently occurring (unusual items) need to be separately presented in the income statement or in the notes to financial statements. [220-20-45-1]

The war may represent an unusual item for some companies. However, judgment is needed to determine the financial effects of the war and related events. Subtopic 220-20 is silent on how to determine which losses and costs are attributable to unusual items. We believe that a reasonable approach is to include direct and incremental costs or gains associated with these events – e.g. property damage, incremental operating expenses for staff security and evacuation. Normal recurring expenses that would be incurred regardless of these events are typically not direct and incremental – e.g. regular payroll costs, overheads or depreciation expense.

Long-lived assets, goodwill and indefinite-lived intangibles

Impairment

The following assets are evaluated for impairment if a triggering event occurs: long-lived assets (e.g. property, plant and equipment, including assets leased by lessors under operating leases; finite-lived intangible assets; and lease ROU assets), goodwill and indefinite-lived intangible assets.

Russia's invasion of Ukraine and the resulting sanctions many nations have placed on the Russian government and Russian companies may give rise to one or more impairment triggering events.

The following are examples (not exhaustive).

Impairment of long-lived assets (including ROU assets)	Examples, consistent with those in Topic 360, of war- or sanctions-related triggering events that may indicate an impairment of long-lived assets include (not exhaustive): [360-10-35-21] — a substantial decrease in the market (rental) price of a facility in, or used to support operations or sales in, Ukraine or Russia; — idling or abandoning an owned or leased facility in, or used to support operations in, Ukraine or Russia; — physical damage to an owned or leased facility or asset located in Ukraine or Russia; — new economic sanctions, including export controls, that affect the utility or value of an owned or leased facility in Ukraine or Russia; or — loss of Ukrainian or Russian customers or increased costs (e.g. of fuel or other commodities) that contribute to current (and expected future) period operating or cash flow losses.	KPMG Handbook, Impairment of nonfinancial assets, discusses long-lived asset impairment in additional detail. Section 6.5.1 of KPMG Handbook, Leases, discusses impairment of lease ROU assets specifically. Section 6.5.2 of KPMG Handbook, Leases, discusses lease ROU asset abandonment in detail.
Impairment of goodwill and indefinite-lived intangible assets	Examples, consistent with those in Topic 350, of war- or sanctions-related triggering events that may indicate it is more likely than not that goodwill is impaired include (not exhaustive): [350-20-35-3C] — reporting unit(s) having significant operations in Ukraine or Russia; — permanent or temporary curtailment of operations; — impact of economic sanctions imposed on Russia and the effect on significant customers or suppliers, including their ability to pay or remain in business; — supply chain disruptions caused by the war or the ensuing sanctions such that the company cannot procure raw materials or components for finished goods; — decline in ability to ship product to or from the affected markets; — workforce limitations in Ukraine or Russia that have impeded the company's ability to manufacture products or provide services to customers; — more-likely-than-not disposition of all or portion of a reporting unit; — volatility in commodity prices that are expected to negatively impact revenues or production costs; — sustained decrease in share price (absolute terms and relative to peers). The impairment indicators for indefinite-lived intangible assets as a result of the war may be similar to those identified above for goodwill. Companies should focus their analysis of indefinite-lived intangible assets on the effect that the war may have on significant inputs used to determine the fair values of these assets. [350-30-35-18B]	KPMG Handbook, Impairment of nonfinancial assets, discusses goodwill and indefinite-lived intangible asset impairment in additional detail.

If a long-lived asset triggering event has occurred, a company determines whether the asset (or asset group) is recoverable (Step 1). If not, then a full impairment test (Step 2) is required. If a goodwill or indefinite-lived intangible asset triggering event has occurred between annual testing dates, the company must perform an impairment test.

Abandonment and idling of long-lived assets

Some companies may have abandoned, or have adopted a plan to abandon, long-lived assets or certain operations in Ukraine or Russia. For example, some companies may have already vacated owned or leased facilities in Ukraine due to, or in anticipation of, the war. When a company commits to a plan to abandon a long-lived asset, it accelerates depreciation (or amortization) of the asset from the date of commitment so that it is depreciated (amortized) to its salvage value (which may be $0) by the date the company will cease use of it. [360-10-35-47 – 35-48]

A long-lived asset is *not* abandoned if it is only temporarily idled. For example, if a company temporarily shutters a manufacturing facility with a long remaining useful life, but intends to resume operations after military activities in the area abate, the facility has not been abandoned. Although temporarily idling a long-lived asset may trigger an impairment of that asset (or asset group to which it belongs), a company does not stop depreciating (amortizing) the asset, or recognizing lease cost in the case of an ROU asset, while it is idle. [360-10-35-49]

Insurance recoveries

Companies should carefully review their insurance policies (e.g. property and casualty, general liability, and business interruption), understand what losses are specifically excluded and evaluate whether claims will qualify for recovery. Some insurance policies may cover losses from terrorism, political violence or war, while other policies may specifically exclude these type of claims.

Insurance recoveries should only be recognized in earnings to the extent that: [410-30-35-8, 450-20-25-1]

— costs and losses clearly attributable to the insurable event have been incurred and recognized in the financial statements; and
— those recoveries are probable (i.e. likely to occur) and estimable.

This probability approach is commonly referred to as the 'loss recovery model'. Assuming the loss recovery model is appropriate, judgment is required to determine the accounting based on the specific facts and circumstances of the claim. Given the significant uncertainty of the current environment, it may be difficult for certain companies to reach the probability threshold until the claim is filed, processed or even settled. Settlement of a claim after the reporting date may indicate that the probability threshold was met at the reporting date. [855-10-25-1]

Insurance recoveries in excess of the costs and losses recognized in earnings are contingent gains. Contingent gains are recognized when settled. Insurance recoveries are excluded from the estimated future cash flows in a long-lived asset recoverability test. [450-30-25-1, 360-10-35-29]

Financial instruments

Impairment of financial instruments	Companies may need to consider whether investments have been affected by the war and related events, and if so, whether they must recognize credit or other impairments. Specifically, a company may need to consider:	KPMG Handbook, Credit Impairment KPMG Handbook, Financial instruments: Recognition and measurement

	— whether these events have been considered in recognizing and measuring credit impairment under Topic 326 for recognized assets (such as loan receivables) and off-balance sheet exposures (such as unfunded loan commitments). Topic 326 requires companies to estimate the effect of current economic conditions and reasonable and supportable forecasts of future economic conditions and their effect on collectibility; — whether it intends to sell available-for-sale debt securities that have been impacted by these events. If a company has the intent to sell an available-for-sale debt security, any allowance for credit losses is written off and the amortized cost basis is written down to the debt security's fair value at the reporting date, with any incremental impairment reported in earnings; — whether equity investments without a readily determinable fair value, and not measured at fair value, are impaired. Topic 321 requires a company to make a qualitative assessment by using impairment indicators to evaluate whether the fair value of the investment is less than its carrying amount. If a company cannot determine that the fair value of the investment is not less than its carrying amount using a qualitative assessment, then the company measures the fair value of the investment at the reporting date and recognizes any impairment in earnings; — whether an other-than-temporary impairment (OTTI) of an equity method investment has occurred. An equity method investment is impaired if its fair value is less than its carrying amount but impairment is only recorded when it is determined to be other-than-temporary. A company should carefully consider the specific facts and circumstances, especially when the investee has significant operations in Ukraine or Russia or has exposure to economic impacts of the war and related events, and provide transparent disclosure about how it has evaluated the recovery of those investments.	Section 5.5 of KPMG Handbook, Equity method of accounting, discusses OTTI impairment.
Fair value measurements	As a result of the war and related events, there may be a significant decrease in the volume or level of activity in the market for an item compared with its normal market activity. If a company concludes that the volume or level of activity for an asset or liability has significantly decreased, further analysis of the transactions or quoted prices may be required. However, a company should not disregard market prices unless those prices are from transactions determined to be disorderly. In addition, the fair value of contracts (e.g. derivatives) entered into with companies in Russia subject to an International Swaps and Derivatives Association master agreement may be affected by the sanctions.	KPMG Handbook, Fair value measurement

Financial guarantees	A company may need to consider whether its estimate of contingent losses related to guarantees it has provided should be increased as a result of the war and related events. Specifically, a company may need to consider: — whether the likelihood of being required to perform has increased; and — whether the amount of the loss upon performance is expected to be higher.	
Hedge accounting	A company may need to consider whether its hedge accounting relationships have been affected by the war and related events. Specifically, a company may need to consider: — whether the forecasted transactions in cash flow hedging relationships remain probable of occurring within the originally forecasted period. For example, as a result of the war and related events, a company may need to cancel or delay planned transactions (such as expected purchases or sales of nonfinancial items) due to factory shutdowns, restrictions on imports or exports, or customer cancellations. When a hedged forecasted transaction is no longer probable of occurring within the originally forecasted period, the hedge relationship may need to be terminated and related deferred gains or losses may need to be reclassified from AOCI to earnings; — whether these events have affected the probability of performance for firm commitments hedged in fair value hedges. If performance is no longer considered probable, the hedge relationship is discontinued and any asset or liability recognized as a result of the hedge relationship is recognized in earnings immediately; — whether these events have caused hedge relationships to be less than highly effective.	KPMG Handbook, Derivatives and hedging
Debt arrangements	As a result of the war and related events, a company's operations in Russia or Ukraine may face declines in operating results leading to cash flow constraints. If it has debt arrangements, its ability to service the debt and/or maintain compliance with its debt covenants may be affected. Such challenges may also lead it to modify its existing debt arrangements. The company may need to consider balance sheet classification of debt as current or noncurrent, and the accounting for debt modifications.	Chapters 3 and 4 of KPMG Handbook, Debt and equity financing

Revenue recognition

The war could create uncertainty for revenue transactions with customers resulting from changes in forecasts driven by supply chain and production disruptions, workforce restrictions, and travel restrictions, among other factors. Companies may also apply certain aspects of the revenue guidance that they had not, or had less frequently, applied in the past – e.g. export and import controls that affect the recognition of revenue.

Revenue recognition	General considerations that may impact revenue recognition due to the war and/or sanctions and related events include: — the effect on variable consideration (e.g. price concessions, rebates, performance bonuses); — the effect on the credit risk of customers in either Russia or Ukraine; — increases in cancellations or other contract modifications from affected customers; — increases in pre-existing contracts no longer meeting the contract existence criteria; — the ability to fulfill contracts; — new customer incentives (e.g. extension of payment terms, free goods) that affect the transaction price being offered; — other estimates (e.g. breakage, measure of progress) for which the economic volatility caused by the war could have an effect.	Section 5.3 of KPMG Handbook, Revenue recognition, discusses variable consideration. Section 11 of KPMG Handbook, Revenue recognition, discusses contract modifications. Section 3.3 of KPMG Handbook, Revenue recognition, discusses the collectibility criterion. Section 13 of KPMG Handbook, Revenue recognition, discusses loss contracts.

Other potential issues

Foreign currency considerations	Facts and circumstances related to Russia and Ukraine may affect whether a company has control or significant influence over its operations or investments in such countries. If there is an other-than-temporary lack of exchangeability between two currencies, a company may need to consider whether it is appropriate to continue to consolidate its investment in a foreign entity. For example, control may not rest with the majority owner (parent) if the subsidiary operates under foreign exchange restrictions, controls or other government-imposed uncertainties so severe that they cast significant doubt on the parent's ability to control the subsidiary. This limitation to consolidation is also a limitation to the use of the equity method.	Section 2.5 of KPMG Handbook, Consolidation
Income taxes	— Companies with operations that are affected by the war and related events may conclude that they cannot reliably estimate their overall annual effective tax rate. In that case, the actual year-to-date effective tax rate may be used as the best estimate of the annual effective tax rate. — Although multinational companies generally calculate one overall estimated annual effective tax rate, some may need to exclude certain jurisdictions depending on the effects of the war. A separate calculation of the effective tax rate in an individual jurisdiction is needed if (a) the jurisdiction has experienced year-to-date losses (or expects losses for the year) for which no	Section 10 of KPMG Handbook, Accounting for income taxes, discusses estimating the annual effective tax rate and treatment of significant and unusual items in more detail. Section 4 of KPMG Handbook, Accounting for income taxes, discusses valuation of deferred tax assets in more detail.

	benefits can be recognized or (b) the company is unable to reliably estimate the effective tax rate for the jurisdiction. — Significant unusual or infrequently occurring items and their related tax effects that companies may identify in connection with the war may need to be recognized entirely in the interim period in which they occur. — Companies that are experiencing unexpected ordinary losses due to the war or capital losses due to the war's effect on the markets may need to analyze whether those conditions result in the inability to realize deferred tax assets.	
Inventory	— Inventory measured using last-in, first-out (LIFO) or the retail inventory method should be based on the lower of cost or market. Determining the replacement cost may present challenges with the war creating supply chain, manufacturing and workplace disruptions, as well as changing prices. — A change in the net realizability of inventory measured using any method other than LIFO or the retail inventory method held in the affected countries may require a writedown to the lower of cost or net realizable value. — Declines in market demand could cause losses from firm, noncancelable and unhedged commitments for the future purchase of inventory. — Overhead costs associated with abnormally low production levels and other variances (e.g. abnormal freight, handling costs and spoilage) are not allocated to inventory and are recognized as an expense in the period in which they are incurred.	Paragraph 330-10-35-1B discusses net realizable value. Paragraph 330-10-35-7 discusses the inventory valuation allowance. Paragraph 330-10-35-18 discusses purchase commitments. Paragraph 330-10-30-7 discusses abnormally low production.
Leases	— The war, sanctions or actions taken by a lessee in response may trigger a requirement for a lessee to reassess and/or remeasure one or more of its leases. — Lessors may conclude it is no longer probable they will be able to collect amounts owed from certain Ukrainian or Russian lessees.	Section 6.6 of KPMG Handbook, Leases, discusses lease reassessments. Section 7.5 of KPMG Handbook, Leases, discusses collectibility.
Compensation and benefits	— Existing performance conditions, market conditions or bonus targets may not be met. — Performance conditions may be modified to include discretionary performance conditions due to the significant future uncertainty. — Market conditions may be modified; compensation expense for share-based payment awards with market conditions is recognized even when the market condition is not achieved. — Leave policies may be modified. — Voluntary or involuntary termination benefits may be offered.	Chapter 4 the KPMG Handbook, Share-based payments, discusses recognition of share-based payment awards with either performance targets or market conditions; also see chapter 5 for modifications to such awards. Chapter 3 of the KPMG Handbook, Employee benefits, discusses compensated absences, bonus and general

		compensation arrangements. Chapter 4 of the KPMG Handbook, Employee benefits, discusses termination benefits.

Considerations for SEC issuers

SEC issuers should consider the adequacy of disclosures about risks and uncertainties in MD&A and other items in periodic filings. Disclosure in periodic SEC filings to address current and evolving events may be appropriate in:

- Item 1. Description of Business
- Item 1A. Risk Factors
- Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations
  - Liquidity
  - Results of Operations – Known Trends and Uncertainties
- Item 7A. Quantitative and Qualitative Disclosures About Market Risk
  - Strategies and policies to manage risks.

Access to information. Companies with significant operations in Russia or Ukraine may encounter delays in receiving (or even an inability to obtain) financial data necessary for the preparation of the consolidated financial statements. The challenges with obtaining such information could also extend to financial information of a subsidiary necessary to comply with the requirements of Regulation S-X Rule 3-09 (equity method investments) or Rules 3-05 and 3-14 (acquired businesses), for example.

ICFR. Companies with significant operations or business transactions in Russia or Ukraine may consider whether there is any effect on internal control over financial reporting. For example, changes or disruptions to a company’s internal control environment may result from the inability to access information, effects on the workforce in those locations, or the need to account for unanticipated unusual events (e.g. accounting for insurance recoveries related to business interruption, including the evaluation of whether the claims are covered by the insurance policy). Disclosure of material changes in ICFR would be required.

Late filings. If companies anticipate filing delays due to the war and related events, they should contact the SEC staff directly to discuss their facts and circumstances. To the extent necessary, companies may consider using Form 12b-25, Notification of Late Filing, to extend reporting time frames. Failure to follow regulations and timely report could result in a company losing its ability to issue securities using Form S-3.

Evolving information

The potential global and economic impacts of the Russia-Ukraine war continue to evolve rapidly, and companies should continue to monitor the situation. Companies are encouraged to maintain close communications with their board of directors, external auditors, legal counsel and other service providers as the circumstances progress. Watch our webpage to stay informed.

kpmg.com/socialmedia