KPMG

Accounting for economic disruption

Handbook



US GAAP

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New chapter added in this edition **

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Navigating the financial reporting implications of economic disruption

Economic disruption may impact companies around the globe at different times and in different ways. Changing trade and tariff policies, geopolitical tensions, supply chain disruptions, and broader macroeconomic developments continue to create uncertainty for companies and their stakeholders. These conditions may affect costs, pricing, demand, access to capital, business operations and interest rates, which in turn may affect multiple areas of accounting and financial reporting.

When faced with economic disruption and the ensuing economic uncertainty it creates, companies must promptly identify potential financial statement impacts and consider the associated accounting and disclosure consequences.

Regulators focus on quality financial reporting during periods of economic disruption, as well as the sufficiency and timeliness of related disclosures. Transparency is at the center of this focus, particularly as it relates to estimation uncertainties and the underlying basis for critical judgments used in financial reporting.

Virtually any financial statement account could face the impacts of economic disruption. Additionally, there are disclosures that may be necessary, such as those related to going concern, impairment, contingencies and risks and uncertainties.

This Handbook serves as a gateway to understanding the many balance sheet and income statement line items and disclosures that could be affected during periods of economic disruption. From that gateway, easy access is provided to a wealth of additional information should you need it.

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About this publication

The quality of financial reporting remains a cornerstone of investor protection during periods of economic and geopolitical transition and is as important during periods of economic disruption as it is during periods of economic prosperity. In recent years, the SEC staff has emphasized maintaining quality financial reporting in the face of economic uncertainty and improving the readability of disclosures amidst significant uncertainty. Major policy shifts – particularly regarding tariffs and trade volatility – can have direct financial reporting implications. The SEC staff highlighted this at the 2025 AICPA Conference on Current SEC and PCAOB developments, underscoring the need for robust risk disclosures and clear, company-specific reporting to help investors navigate potential consequences. A summary of these developments and their impact on reporting quality can be found here.

The purpose of this publication is to assist you when considering the impact of economic disruption on a company's financial statements and related disclosures. It is meant to be read in conjunction with the referenced literature. Due to the nature and uncertainty surrounding economic disruption, this publication cannot provide an exhaustive list of considerations.

Scope

This publication deals with both potential macroeconomic disruption as well as company-specific issues.

While equally important in preparing financial statements, the implications of economic uncertainty on estimates and valuations in the financial statements are often less clear because they may only impact one of many inputs to a single estimate or valuation.

The scope of this Handbook is on US GAAP financial reporting and disclosure implications of economic disruption. However, economic disruption can also have a significant impact on a company's system of internal controls. KPMG Handbook, Internal control over financial reporting, provides detailed insights on the importance of maintaining effective internal controls and how to employ a risk-based approach in their evaluation.

Organization of the text

Each chapter of this publication begins with a section titled, 'Questions to ask'. If the answer to any of these questions is 'yes', then further analysis is warranted to determine the impact to the financial statements. Specific considerations and references to additional sections are provided for further information.

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Our commentary is referenced to the *FASB Accounting Standards Codification*® and to other literature, where applicable. The following are examples:

- 606-10-32-11 is paragraph 32-11 of ASC Subtopic 606-10.
- Reg S-K Item 303(b)(2)(ii) is paragraph (b)(2)(ii) of Item 303 of SEC Regulation S-K.
- 2009 AICPA Conf is the AICPA Conference on Current SEC and PCAOB Developments held in 2009.

November 2026 edition

This edition of the Handbook includes additional considerations for companies during periods of economic disruption, including a new chapter on government grants and assistance, which may be particularly prevalent during such periods. Compared to the July 2025 edition, new items are identified with ** and items that have been significantly updated or revised are identified with #. A summary is included in the Index of changes.

Abbreviations

We use the following abbreviations in this publication.

AFS	Available-for-sale
AICPA	American Institute of Certified Public Accountants
AOCI	Accumulated other comprehensive income
COSO	Committee of Sponsoring Organizations of the Treadway Commission
EIR	Effective interest rate
FASB	Financial Accounting Standards Board
FIFO	First-in, first-out
HFS	Held-for-sale
HTM	Held-to-maturity
IBR	Incremental borrowing rate
LCM	Lower of cost or market
LIFO	Last-in, first-out
MD&A	Management's Discussion & Analysis
NPNS	Normal purchases and normal sales
NRV	Net realizable value
RIM	Retail inventory method

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ROU	Right-of-use
SAC	Subjective acceleration clause
SEC	US Securities and Exchange Commission
TDR	Troubled debt restructuring
US GAAP	Generally accepted accounting principles
WIP	Work in progress

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1. Executive summary

Item significantly updated in this edition #

What is economic disruption?

Merriam-Webster defines *economic (adjective)* as "of, relating to, or based on the production, distribution, and consumption of goods and services"[1] and *disruption (noun)* as "the act or process of disrupting something: a break or interruption in the normal course or continuation of some activity, process, etc."[2] Put together, economic disruption is the interruption of the normal course or continuation of the production, distribution, or consumption of goods or services.

In today's interconnected world, current events of all kinds can impact economies on a local or global scale. Events, whether natural, political, or manufactured, can have significant impacts on those economies and the businesses operating in them. These disruptions often cascade through global supply and distribution chains and have unexpected impacts that can cross borders and extend across multiple reporting periods.

What events can cause economic disruption?

Economic disruption can be caused by a variety of one-off events, or it may be cumulative, resulting from a combination of events and/or underlying issues that directly or indirectly impact a company or its industry. Economic disruption may develop over the course of many years, or it may be sudden and triggered by an identifiable event, such as a natural disaster.

The form of the disruption may vary depending on the nature of the company's operations or industry. Examples of macroeconomic events that can cause economic disruption are included below.

Catalysts for economic disruption (not exhaustive)
Political instability, war, terrorism
Economic sanctions affecting countries a company operates in or countries in which key customers or suppliers of the company operate
Global trade, supply chain, transportation or energy markets instability

[1] "economic," *Merriam-Webster.com Dictionary*, https://www.merriam-webster.com/dictionary/economic. Accessed November 13, 2026.
[2] "disruption," *Merriam-Webster.com* Dictionary, https://www.merriam-webster.com/dictionary/disruption. Accessed November 13, 2026.

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Catalysts for economic disruption (not exhaustive)
Changing tariffs and trade policies
Inflation, hyperinflation
Changing interest rates
Recession
Natural disasters (e.g. hurricanes, floods, earthquakes, wildfires)
Regulatory instability (e.g. Brexit)
Pandemic or endemic diseases (e.g. COVID-19)

The timely identification of these events is important not only to the operations of the company, but also its financial reporting process given the specific considerations and disclosures that may be required.

What are the effects of economic disruption?

Economic disruption can have a variety of impacts, both expected and unexpected, and those impacts may vary by company and industry. Examples of these impacts are included below.

Potential impacts from economic disruption (not exhaustive)
Increased cost of capital
Share price declines
Declines in credit worthiness/liquidity of customers, vendors or other counterparties
Labor shortages, lack of skilled workforce
Supply chain disruptions
Transportation and logistical constraints
Facilities/assets damaged, destroyed, idled, abandoned or rendered inaccessible
Reduced revenue, increased production costs
Commodity and energy price volatility
Employee layoffs or restructurings
Declines in fair market value of investments
Volatility in demand forecasting and inventory planning
Changes to procurement strategies, vendor contracts or sourcing geographies
Strategic relocation or restructuring of manufacturing operations
Early termination or renegotiation of supplier and customer agreements
New government assistance programs, tax incentives or subsidies

Impacts of economic disruption can cause further ripples through an interconnected supply chain, expanding the overall economic disruption beyond the initially impacted region(s).

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For example, geopolitical conflicts and the response of governments and other organizations (e.g. sanctions, trade restrictions, other economic measures) may affect not only companies operating in the affected region, but also companies with significant operations, customer bases or supply chains connected to the region.

Similarly, the imposition or escalation of tariffs can disrupt global supply chains, increase input costs and alter sourcing strategies, affecting even companies that do not directly do business in or with businesses in countries facing tariffs. Determining the breadth and duration of these disruptions can be challenging for management of companies affected.

Additionally, to mitigate the impacts of economic disruptions, a company may implement measures to protect both itself and its stakeholders by positioning itself to weather the period of disruption in the best possible way. For example, to mitigate the impact of labor shortages, management may restructure employee benefit packages or implement a new employee retention program. To address tariff-related disruption, companies may increase prices, renegotiate supplier contracts, diversify sourcing geographies or relocate manufacturing operations to reduce exposure.

When faced with economic disruption, companies must timely identify potential financial statement impacts and consider the related accounting and disclosure consequences (see below). Additionally, the board of directors and management need to consider the overall impact of changes in business operations to the entity's internal controls over financial reporting.

How is financial reporting affected by economic disruption?

This Handbook focuses on potential financial reporting impacts that companies reporting under US GAAP may experience in periods of economic disruption.

Potential financial reporting impacts from economic disruption (not exhaustive)
Going concern disclosures
Changes to risks and uncertainties
Contract modifications or terminations
Changes in estimates
Impairment of assets
Changes in classification of assets and liabilities
Restructurings
Disposals resulting in held-for-sale disposal groups or discontinued operations
Government grants and assistance

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These impacts are not exhaustive because events causing economic disruption can be unprecedented with complex and unforeseen effects on the financial statements and related disclosures.

The chapters of this Handbook focus on these and other financial reporting effects of economic disruption on key elements and aspects of the financial statements.

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2. Revenue

Detailed contents

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2.8 Estimates

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2.1 Questions to ask

Economic disruption may impact revenue transactions. Changes in consumer spending and sentiment, credit deterioration, supply chain and production disruptions, tariffs, evolving trade policies, labor shortages, inflation and other factors may impact both the seller of the goods and/or services as well as the customer. These events may also lead sellers to first or more frequently apply certain aspects of the revenue guidance and evaluate a number of different estimates and judgments.

The following are examples of questions to consider that are specific to economic disruption and the potential impact to revenue and associated accounts (not exhaustive).

QUESTION	ADDITIONAL INFORMATION
Is the company providing any form of pricing incentives or other variable consideration to new or existing customers, such as: • price concessions; • performance bonuses or fees; • return rights; • price protection clauses; • rebates, credits and coupons; • service level agreements and liquidated damages; • trailing commissions; • price adjustment clauses; or • other price changes?	Section 2.2
Is the company providing other types of incentives to new or existing customers, such as: • free goods or services; • options for goods or services; • extended payment terms; • payments on a customer's behalf (e.g. interest, financing fees); or • upfront cash payments to sign a contract?	Section 2.3
Has the company's ability to collect (or the customer's ability to pay) the contract consideration deteriorated or otherwise been negatively affected such that: • it is not (or is no longer) probable that the company will collect substantially all of the consideration to which it expects to be entitled in exchange for the goods or services that will be transferred; or • lifetime expected credit losses on trade receivables and customer contract assets have increased?	Section 2.4
Has there been an increase in contract cancellations or other contract modifications?	Section 2.5

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QUESTION	ADDITIONAL INFORMATION
Has the company changed the prices at which it sells its goods or services such that its estimates of stand-alone selling prices would be affected?	Section 2.6
Has the recoverability of contract costs changed such that: • contract cost assets or total contract costs may no longer be recoverable; or • contract cost assets may be recoverable over a different period (e.g. because there has been a change in the anticipated volume of contract renewals)?	Section 2.7
Have other estimates made by the company to account for its customer contracts been impacted, such as: • the measure of progress toward completion of a contract; • the redemption of loyalty points or use of loyalty programs by customers; • the breakage expected on company gift cards; or • those needed to determine whether a significant financing component exists and, if so, to account for the significant financing component (e.g. discount rate, payment timing)?	Section 2.8
Do the company's revenue-related disclosures appropriately capture the uncertainty of revenue and cash flows arising from contracts with customers?	Section 2.9

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2.2 Variable consideration

Variable consideration, like fixed consideration, is part of a revenue contract's transaction price. However, Topic 606 (revenue) requires that variable consideration be estimated and constrained to an amount that is not probable of significant reversal when the uncertainty is subsequently resolved. Variable consideration takes many forms, can be explicit or implicit, is estimated at contract inception and updated each subsequent reporting period until the uncertain amount is known. [606-10-32-11, 32-14]

In periods of economic disruption, these estimates can involve increased uncertainty, and previously established estimates may need to be revised. In addition, a company's *past* experience with similar types of contracts may not be predictive in the *current* environment.

There are several categories of variable consideration that companies must think through when navigating the accounting impacts of economic disruption.

Price concessions (explicit and implied)	• Identify price concessions in response to decreases in customer demand. • Price concessions may be implied from past business practices, published policies or specific statements. • A history of providing price concessions can be created with relatively few instances of such price concessions having occurred. • If a company grants a price concession when there is no previous pattern of such concessions, which is expected to be infrequent, the company accounts for that price concession as a contract modification.
Performance bonuses or fees	• Reevaluate if estimated variable consideration contingent on future events (e.g. investment returns, performance metrics) is required to be constrained. • Constraints due to labor shortage, supply chain issues or other disruptions create a higher likelihood of revenue reversal for performance fees. • The degree of uncertainty may require applying a full constraint (i.e. no related revenue recognized) in some situations (e.g. investment performance fees based on market returns).
Return rights	• Monitor returns for sudden changes in customer behavior. • Higher returns than historical experience may indicate that customers have an unexpected cash flow and liquidity need. • Elements of a return lag analysis may need to be reconsidered or updated to reflect current expectations or trends due to the disruption. • Estimates will also need to be adjusted for changes in company policy or practice (e.g. companies may waive certain restrictions on returns or extend return periods).

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Price protection clauses	• Determine if price reductions trigger existing price protection clauses. • Companies may provide price protection in arrangements in which they previously had not.
Rebates, credits and coupons	• Revisit expectations applied to retrospective volume rebates or discounts and credits. • Disruptions may impact customers' volume of purchases from what was previously estimated. • Changes to volume rebate targets or coupon and discount plans will require changes to previous estimates (e.g. companies may lower volume targets or increase discounts to attempt to incentivize purchases).
Service level agreements and liquidated damages	• Evaluate whether disruptions to operations cause delays in projects that could subject the company to various penalties and liquidated damages. • Customer contracts that include fixed price consideration may also include service level guarantee provisions and related penalties. • Companies should consult legal counsel to determine whether force majeure clauses permit nonperformance without incurring a penalty.
Trailing commissions	• Consider how economic disruption may affect renewal rates and estimated revenue for arrangements with trailing commissions. • Trailing commissions are when an agent brokers a sale to an end customer and receives subsequent payments each time the end customer renews.
Price adjustment clauses	• Evaluate whether the company has an enforceable right to pass along increased costs (e.g. tariffs) to customers.
Other price changes	• Consider whether the change in price is: – related to the resolution of variable consideration identified and agreed upon under an existing contract; or – arises from a contract modification, which is the result of a separate and subsequent negotiation between the two parties (see section 2.5).

See sections 5.2, 5.3, 5.4, 6.8 and chapter 11 of KPMG Handbook, Revenue recognition, for further guidance on the accounting for variable consideration, changes in transaction price and contract modifications.

2.3 Customer incentives

In response to customer demand, companies may provide their customers with a variety of incentives. Customer incentives are accounted for differently under Topic 606 depending on their nature. Many of the types of customer incentives that may impact the transaction price are discussed above in variable consideration. Other types of customer incentives may include (not exhaustive):

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- free goods or services, which may be a separate performance obligation (see section 4.2 of KPMG Handbook, Revenue recognition, for further guidance);
- options, which may convey material rights (e.g. loyalty points, future discounts or coupons) (see chapter 8 of KPMG Handbook, Revenue recognition, for further guidance);
- extension of payment terms, which could impact the assessment of collectibility (see section 2.4), price concessions (see section 2.2) and significant financing components (see section 2.8) (see also KPMG Handbook, Revenue recognition, for further guidance on evaluating extended payment terms and price concessions, in particular section 3.3 for collectibility, sections 3.4 and 5.3 for price concessions and section 5.5 for significant financing components);
- payment of financing fees or interest for customer financing, which could impact variable consideration (see section 2.2) and consideration payable to a customer (see section 5.7 of KPMG Handbook, Revenue recognition, for further guidance); and
- other consideration payable to a customer (e.g. upfront cash payments to sign a contract) (see section 5.7 of KPMG Handbook, Revenue recognition, for further guidance).

In a period of economic disruption, these incentives could be made outside the normal channels (e.g. senior leadership discussions with key customers). Companies need to be aware of any promises outside of written contracts because verbal promises can create implied performance obligations or affect transaction price.

See sections 4.2 and 5.7 and chapter 8 of KPMG Handbook, Revenue recognition, for further guidance.

2.4 Assessing collectibility, receivables and contract assets

Collectibility of consideration is a criterion under Topic 606 that must be met for a contract to exist under the revenue model. Many types of economic disruption may have the effect of degrading consumer credit quality. These increases in credit risk may be relatively short lived or more long term. For example, while a natural disaster may impact the credit risk of affected customers:

- for those in lightly impacted areas, that effect may be short lived or minor; whereas
- for those in significantly impacted areas, that effect may be more long term due to job losses.

Customer credit risk could increase significantly and quickly as economic activity declines abruptly or continues to decline and/or as unemployment or underemployment rises. This potentially impacts the timing and amount of

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revenue to be recognized as well as the valuation of receivables and contract assets.

Contract existence

As noted above, the collectibility criterion must be met for a contract to exist, and credit risk is a key factor in assessing this criterion. Under the collectibility criterion, it must be probable that the company will collect substantially all of the consideration to which it expects to be entitled in exchange for the goods or services that will be transferred. This requires the company to evaluate the customer's ability (i.e. their financial capacity) and intent to pay the promised consideration (transaction price inclusive of any variable consideration). [606-10-25-1]

Contract inception

In periods of economic disruption, a company may determine that a customer's creditworthiness is such that the collectibility criterion is not met at a contract's inception. In this instance, the company cannot apply Topic 606's general revenue model. Instead, it follows the alternative model for recognizing revenue, which is a deposit model that does not allow for revenue to be recognized unless the company receives nonrefundable consideration and one of three events has occurred. A company cannot record revenue based on collections unless the criteria under this deposit model are met, and therefore, the accounting is not the same as 'cash basis' or 'installment' accounting. [606-10-25-7]

Sections 3.3 and 3.6 of KPMG Handbook, Revenue recognition, discuss the collectibility criterion and the alternative model for recognizing revenue, respectively.

Post contract inception

A company does not reassess the collectibility criterion for contracts previously determined to exist unless there is a significant change in facts and circumstances that results in a significant deterioration in the customer's creditworthiness. This may occur in periods of economic disruption, such as an economic recession, a sudden economic downturn or a political event that affects the parties' contractual commitments. Companies need to evaluate whether significant changes in credit risk have occurred and, if so, reevaluate the collectibility criterion for existing contracts. If a company determines on reassessment that collectibility is no longer probable, it discontinues using the general revenue model and follows the alternative (deposit) model. However, the company does not reverse revenue previously recognized. [606-10-25-5]

Section 3.5 of KPMG Handbook, Revenue recognition, discusses the reassessment of contract existence criteria.

Changes to collectibility assessment

When a company expects to collect less consideration on an existing contract (meaning the collectibility criterion was met), the company determines whether the shortfall is due to a price concession (variable consideration) or a change in the customer's ability and intention to pay (collectibility). This determination

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requires judgment. If the shortfall is a price concession, the company recognizes it as a reduction to revenue. In contrast, if the shortfall is a result of a change in the customer's ability and intention to pay, the company recognizes credit loss expense based on an assessment of impairment of the receivable. [606-10-55-99 – 55-105]

See sections 3.3 through 3.6 of KPMG Handbook, Revenue recognition, for further guidance on how credit risk is evaluated under Topic 606.

Receivables and contract assets

A company assesses both receivables and contract assets for impairment under Subtopic 326-20 (credit losses). Expected credit losses may increase significantly during times of economic disruption.

To read more, see section 3.2.

2.5 Contract modifications

In periods of economic disruption, customers may experience financial difficulty in a variety of forms and durations, leading to an increase in contract cancellations or other contract modifications. In response to increased costs (e.g. due to tariffs), companies may seek to modify existing contracts to recover those costs from customers.

It's important to remember that when determining the transaction price, a company assumes that the goods or services will be transferred to the customer based on the enforceable rights and obligations in the contract. Therefore, a company does not consider the possibility of the contract being canceled, renewed or modified. For example, if a company has an enforceable contract for which it now expects the customer to cancel and pay a termination penalty, it does not include that termination penalty in its estimate of transaction price, but instead accounts for the cancellation when it is approved. However, a company must distinguish between changes in transaction price that result from resolution of variable consideration (see section 2.2) and those that represent a contract modification that changes the existing enforceable rights and obligations in the contract. [606-10-25-10]

All modifications are accounted for when they are approved. A contract modification is accounted for on a cumulative catch-up basis or prospectively, depending on the type of modification to the contract. If the contract does not promise additional distinct goods or services, the modification is generally accounted for on a cumulative catch-up basis. If the modification adds additional distinct goods or services to the arrangement, the modification is generally accounted for prospectively, with a reallocation of remaining revenue under the original contract if the goods or services are not priced at their stand-alone selling prices. [606-10-25-10, 25-12, 25-13]

Aspects of the accounting for contract modifications may be more challenging in periods of economic disruption, particularly if a company changes the prices at which it is willing to sell its goods or services. The accounting for contract modifications on a prospective basis depends on the stand-alone selling prices of the distinct goods or services at the time of the contract modification.

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Frequent, inconsistent or rapidly changing prices will make it difficult to determine the stand-alone selling price. It may be important to focus on whether there is a past performance issue when the price in the modification is lower than the price in the original contract.

If a contract is modified to permit the company to pass along increased costs to the customer (e.g. tariffs), the increased sales price is recorded in revenue. Even if a tariff surcharge is explicitly shown on the customer invoice, the surcharge amount is recognized as additional revenue, while the related tariff costs are incremental costs of sales. These amounts are not netted against each other.

See chapter 11 of KPMG Handbook, Revenue recognition, for further guidance on the accounting for contract modifications.

2.6 Stand-alone selling prices

The prices at which companies are willing to sell their goods or services may change during periods of economic disruption. For example, companies may seek ways to incentivize their customers to make purchases or to pass increased costs on to their customers. Price changes will affect the allocation of consideration in contracts because stand-alone selling prices will need to be revised for new or modified contracts. The stand-alone selling prices for a previously allocated arrangement are not revised even if the prices change after contract inception. However, in the case of a contract modification that is not accounted for as a separate contract, the company uses stand-alone selling prices at the date of the modification.

The stand-alone selling price is determined for each performance obligation at contract inception and must reflect currently available information, including shifts in pricing and customer base. Depending on the facts and circumstances, some companies may have reasonably concluded that stand-alone selling prices established on a quarterly or annual basis reflect the stand-alone pricing for that entire period. These conclusions will likely need to be revisited in periods of economic disruption. [606-10-25-10]

See section 6.3 of KPMG Handbook, Revenue recognition, for further guidance.

If a customer option to acquire additional goods or services represents a material right, the option's stand-alone selling price incorporates the likelihood that the customer will exercise the option. Customer behavior regarding the exercise of options (including renewals) may change during periods of economic disruption. Topic 606 permits an alternative approach to estimating the stand-alone selling price of a material right when certain criteria are met. Under this alternative approach, the allocation of the transaction price is based on the goods or services a company expects to provide during the initial and renewal periods. Therefore, for new material rights, expectations about the likelihood of renewals and other options being exercised may need to be revised to reflect changes in customer behavior during periods of economic disruption. [606-10-55-44, 55-45]

See section 8.5 of KPMG Handbook, Revenue recognition, for further guidance.

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2.7 Contract costs

Contract cost asset impairment

Contract cost assets relate to costs to obtain a contract or costs to fulfill a contract and are evaluated for impairment. While Subtopic 340-40 on contract cost assets does not specify how often a company assesses those assets for impairment, we believe companies should evaluate whether impairment has occurred whenever events or changes in circumstances indicate that the carrying amount of a contract cost asset may not be recoverable. Such events or changes in circumstances may include, but are not necessarily limited to, the following:

- contract modifications, including changes in price, contract terminations and scope changes;
- changes in expectations as to whether customers will renew/extend existing contracts, or specific goods or services in a contract, to which contract cost assets relate;
- changes in estimates of expected costs to fulfill one or more performance obligations in a contract; and/or
- changes in estimates of the amount of consideration that the company expects to receive from the customer (i.e. collectibility).

Impairment losses are recognized to the extent the carrying amount of the asset exceeds its recoverable amount. The recoverable amount is based on the amount of consideration expected to be received in exchange for the goods or services to which the contract cost asset relates less the costs directly related to providing those goods or services. [340-40-35-3]

To determine the amount of consideration expected to be received, a company uses the principles for determining the transaction price with the following two key differences. [340-40-35-4]

1. It does not constrain any estimate of variable consideration.
2. It adjusts the amount to reflect the effects of the customer's credit risk.

The expected consideration also includes amounts the company has received related to those contract cost assets but has not recognized as revenue (i.e. contract liabilities). [340-40-35-3]

The specific contract cost asset impairment guidance in Subtopic 340-40 is applied *after* existing asset-specific impairment guidance, such as Topic 330 for inventory, but *before* applying the impairment guidance applicable to long-lived identifiable assets and goodwill. [340-40-35-5]

Section 12.9 of KPMG Handbook, Revenue recognition, discusses impairment of contract cost assets.

Amortization of contract cost assets

Companies may also need to evaluate both the period and pattern of amortization to determine whether changes in amortization for contract cost

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assets are necessary. The amortization period for contract cost assets includes anticipated renewals, and therefore, declines in anticipated renewals may result in an acceleration of amortization. The amortization pattern is consistent with the transfer to the customer of the goods or services to which the asset relates. To the extent customer behavior or business disruption changes the timing of transfer, the pattern of amortization also changes. [340-40-35-1, 35-2]

Sections 12.6 to 12.8 of KPMG Handbook, Revenue recognition, discuss the amortization of contract cost assets.

Loss contracts

Topic 606 does not provide specific guidance on the accounting for loss contracts. Instead, a company must evaluate whether its contracts are in the scope of other US GAAP topics that contain requirements for the accrual of a loss on a contract. For contracts that are not in the scope of industry- or transaction-specific loss contracts guidance, losses are not accrued by analogy to that guidance and anticipated losses on those contracts are not recognized. As a result, some companies may have contracts with customers where an accrual for a loss is required and other contracts where accrual of an anticipated loss is prohibited. Economic disruption may increase the likelihood of a loss on a contract and require revisions to estimates.

See chapter 13 of KPMG Handbook, Revenue recognition, for further guidance.

2.8 Estimates

Accounting for revenue from contracts with customers inherently depends on the facts and circumstances because contracts can take a variety of forms and include both explicit and implicit terms. Companies must evaluate all estimates included in the revenue recognition process that could be impacted by economic disruption, following the applicable Topic 606 guidance.

Economic disruption could affect a number of different estimates, many of which are discussed above. Other estimates to consider include the following.

- **Measures of progress.** Supply chain and workforce disruption, as well as new or increased tariffs, may cause changes in expected costs or project delays, which will affect certain measures of progress. For example, increases in estimated costs to complete may affect the timing of revenue recognition if the contract does not permit the company to pass those costs on to the customer. See section 7.4 of KPMG Handbook, Revenue recognition, for further guidance.
- **Breakage estimates.** As customers begin to deal with liquidity challenges, changes in their behavior may occur. For example, customers may redeem more loyalty points than a company previously expected, or a company may experience less breakage on the usage of gift cards. See section 7.6 of KPMG Handbook, Revenue recognition, for further guidance.
- **Significant financing components.** The extension of payment terms could create significant financing components for which discount rates and timing of payment and performance need to be estimated. Increasing interest rates

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can also impact the evaluation of the significance of a financing component. See section 5.5 of KPMG Handbook, Revenue recognition, for further guidance.

When companies apply the portfolio approach or use portfolios of data to make estimates, they need to consider the effect the economic disruption may have on their portfolios. Portfolios and estimates based on customers' past behavior may not indicate their behavior in a current uncertain environment. The economic conditions may affect varying types of customers or contracts in different ways, which may result in the need to stratify portfolios and data in different ways.

2.9 Revenue disclosures

The disclosure objective in Topic 606 is for a company to provide financial statement users with sufficient information to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The uncertainty caused by economic disruption will give rise to potential changes in a number of disclosures, including but not limited to: [606-10-50-1]

- additional significant judgments and changes in the judgments made in applying Topic 606;
- additional categories of revenue disaggregation;
- credit losses recorded on any receivables or contract assets;
- explanations of significant changes in contract balances (including qualitative and quantitative information);
- information about performance obligations, including significant payment terms and returns, refunds and other similar obligations;
- revenue recognized in the reporting period from performance obligations satisfied (or partially satisfied) in previous periods (e.g. changes in transaction price); and
- the aggregate amount of the remaining transaction price and when the company expects to recognize the amounts as revenue.

A company's evaluation of their disclosures includes determining whether they accurately reflect the uncertainty caused by economic disruption and meet the disclosure objective of Topic 606.

See chapter 15 of KPMG Handbook, Revenue recognition, for further guidance.

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3. Financial assets, derivatives and hedging

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3.1 Questions to ask

Companies may hold a variety of financial instruments such as investments in debt and/or equity securities or derivative instruments. Companies may also have off-balance sheet credit exposures through financial guarantees and exposure to expected credit losses through accounts receivable.

Economic disruption may cause recessionary conditions such as inflationary pressures, rising interest rates or changes to credit risk. This additional uncertainty may increase the level of complexity in accounting for financial instruments and require companies to perform additional levels of analysis.

The following are examples of questions management may ask when evaluating the overall impact of economic disruption on expected credit impairment, loan modifications by lenders, transfers between categories of debt securities, derivatives and hedging, equity securities and fair value measurement (not exhaustive).

QUESTION	ADDITIONAL INFORMATION
Credit impairment	
Have estimated expected credit losses for financial assets measured at amortized cost (e.g. trade receivables, loans, HTM debt securities) been affected by: • changes in the estimated contractual term due to changes in expected prepayments; • changes in risk characteristics of financial assets in a pool on which a collective assessment is based; • changes in assumptions about relevant historical loss experience, forecasts or reversion; • changes in whether a financial asset is collateral-dependent, in whether the guidance for collateral-dependent financial assets must be applied and/or in the fair value of collateral; • changes in the likelihood of funding off-balance sheet credit exposures (e.g. guarantees, unfunded loan commitments not unconditionally cancellable by the issuer) or in the amount of loss expected if funding were to occur; or • information received after the reporting date?	Section 3.2.10
Has the likelihood or extent of credit impairment for AFS debt securities been affected by: • a decline in the fair value of an AFS debt security below amortized cost;	Section 3.2.20

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QUESTION	ADDITIONAL INFORMATION
• a change in whether the company intends to sell (or will more likely than not be required to sell) an AFS debt security before recovery of the amortized cost basis; or • a change in whether impaired AFS debt securities are deemed uncollectible?	
Loan modifications – lender	
Have loans been modified?	Section 3.3
Have assumptions used in estimating expected credit losses been impacted by loan modifications?	Section 3.3.10
Do the lender's disclosures appropriately capture information about loan modifications involving principal forgiveness, interest rate reductions, other-than-insignificant payment delays or term extensions?	Section 3.3.20
Transfers between categories of debt securities	
Have any HTM debt securities been sold or transferred before their maturity or have there been other changes in facts and circumstances that require a transfer of debt securities between classifications, including transfers out of HTM?	Section 3.4
Derivatives and hedging	
Does a financial instrument or other contract no longer meet the definition of a derivative or does a derivative no longer qualify for the normal purchases and normal sales scope exception?	Section 3.5.10
Is a hedging relationship no longer considered highly effective?	Section 3.5.20
Has modification of a hedged item or transaction resulted in a requirement to dedesignate or partially dedesignate a hedging relationship?	Section 3.5.30
Is it no longer probable that a forecasted transaction in a cash flow hedge will occur within the timeframe specified at hedge inception or are there net derivative losses related to cash flow hedges in AOCI that must be reclassified into earnings?	Section 3.5.40
Is performance no longer probable under a firm commitment designated as the hedged item in a fair value hedge?	Section 3.5.50

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QUESTION	ADDITIONAL INFORMATION
Equity securities	
Does an equity security no longer have a readily determinable fair value?	Section 3.6.10
Has an equity security without a readily determinable fair value that is measured using the measurement alternative been assessed for impairment?	Section 3.6.20
Fair value measurement	
Have any of the inputs used to measure the fair value of financial assets, such as the volume or level of market activity for an item, been impacted?	Section 3.7

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3.2 Credit impairment

The expected credit loss guidance in Topic 326 is divided into two substantive subtopics, each of which contains a different credit loss model.

- Subtopic 326-20 applies to financial assets measured at amortized cost, including (but not limited to) trade receivables, loans and HTM debt securities. It also applies to net investments in leases, contract assets recognized under Topic 606 (revenue) and off-balance sheet credit exposures such as letters of credit, unused lines of credit and guarantees.
- Subtopic 326-30 applies to available-for-sale (AFS) debt securities.

3.2.10 Estimating expected credit losses for financial assets measured at amortized cost

Subtopic 326-20 requires lifetime expected credit losses of a financial asset to be recognized when the asset is purchased or originated. Subsequent changes in expected credit losses are recognized immediately in net income. [326-20-30-1, 35-1]

Factoring in certain economically disruptive events likely results in an increase in the allowance for expected credit losses. Furthermore, a company considers how it will disclose the information management used in developing its estimated credit losses, including influential factors such as past events, current conditions, and reasonable and supportable forecasts about the future.

See KPMG Handbook, Credit impairment, for further discussion of estimating expected credit losses.

Contractual term – prepayments

Subtopic 326-20 requires an entity to estimate expected credit losses over a financial asset's contractual term. The contractual term is adjusted for expected prepayments. [326-20-30-6]

Because expected credit losses are estimated over the contractual term, the determination of the contractual term generally significantly affects the size of the allowance for credit losses. In general, the longer the contractual term, the larger the allowance for credit losses. During periods of economic disruption, prepayment expectations may be challenging to estimate if there are not historical periods of similar disruption.

See section 6.2.40 of KPMG Handbook, Credit impairment, for further discussion of expected prepayments.

Collective assessment

Expected credit losses for financial assets are estimated on a collective – i.e. pool – basis. Financial assets with similar risk characteristics are pooled. An entity evaluates whether a financial asset in a pool continues to exhibit similar risk characteristics with other financial assets in the pool. A financial asset is

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moved to another pool or evaluated individually if it does not continue to share similar risk characteristics with other financial assets in the pool. [326-20-30-2, 35-2]

In periods of economic disruption, an entity may need to revise the composition of the financial assets in a pool if there are changes in credit risk or other risks such that the assets are no longer considered to share similar risk characteristics.

See chapter 5 of KPMG Handbook, Credit impairment, for further discussion of collective assessment.

Historical loss experience, forecasts and reversion

The estimate of expected lifetime credit losses is based on information relevant to the collectibility of cash flows. It incorporates a number of assumptions, generally using historical loss experience as the starting point with adjustments to reflect differences in asset-specific risk characteristics and economic conditions (both current economic conditions and reasonable and supportable forecasts of future economic conditions). When a company is not able to make or obtain reasonable and supportable forecasts of future economic conditions for the entire life of a financial asset, it is required to estimate expected credit losses for the remaining life using an approach that reverts to historical credit loss information (a 'reversion method'). [326-20-30-7 – 30-9]

Companies consider the effect of current events when developing these assumptions. In periods of economic disruption, estimating the effect of current and future economic conditions may be challenging as companies may not have historical loss information for a period of similar economic decline. Economic disruption may also:

- change the length of the period for which a company can make or obtain a reasonable and supportable forecast; or
- impact whether a reversion method selected in earlier periods continues to result in the company's best estimate of expected credit losses over the remaining contractual term.

Companies consider whether events resulting in economic disruption (e.g. the imposition of tariffs) indicate adjustments are needed to reflect differences compared to historical loss information that relate to asset-specific risk characteristics and/or economic conditions. Adjustments to historical loss experience for differences related to asset-specific risk characteristics are required for the timeframe to which the identified incremental risk applies, which may include periods for which the company cannot reasonably and supportably forecast economic conditions. However, adjustments to historical loss experience for differences related to economic conditions are prohibited for subsequent periods once the company cannot reasonably and supportably forecast economic conditions.

A company may have previously determined that the expected credit losses associated with some financial assets (e.g. certain HTM debt securities) would not be significant because of their high credit quality. Those determinations may need to be revisited because credit declines may cause the estimate of expected credit losses to become significant.

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See chapter 7 of KPMG Handbook, Credit impairment, for further discussion of historical loss experience, forecasts and reversion.

Collateral-dependent financial assets

A financial asset is collateral-dependent when the debtor is experiencing financial difficulty and repayment is expected to be provided substantially through the sale or operation of the collateral. Subtopic 326-20 includes specific guidance for collateral-dependent financial assets that uses the fair value of the collateral at the reporting date to estimate expected credit losses. An entity can apply that guidance to any collateral-dependent financial asset and is required to apply it if foreclosure is probable. [326-20-35-4 – 35-5]

In periods of economic disruption, it may be more likely that a financial asset is collateral-dependent and/or that foreclosure is probable. Additionally, during periods of economic disruption and uncertainty, estimating fair value measurements of collateral may pose unique challenges.

See section 10.2 of KPMG Handbook, Credit impairment, for further discussion of estimating expected credit losses for collateral-dependent financial assets. For further discussion of how to measure fair value, see section 3.7.

Off-balance sheet credit exposure

A company estimates a liability for expected credit losses for off-balance sheet credit exposures (e.g. guarantees or unfunded loan commitments) if it has a present contractual obligation to extend credit and it cannot unconditionally cancel the obligation. Estimating this liability typically requires assumptions about both the likelihood of funding and the amount of loss that would be expected if funding were to occur. [326-20-30-11]

A company may have to revise these assumptions to reflect changing economic conditions. For example, in an economic environment with increasing uncertainty (e.g. due to high inflation or disruption in supply and demand), some borrowers – especially those that may have experienced a recent deterioration in credit quality – may be more likely to exercise loan commitments or draw down unfunded lines of credit. Additionally, higher expected losses may be anticipated if funding were to occur.

See chapter 13 of KPMG Handbook, Credit impairment, for further discussion of estimating credit losses related to off-balance sheet credit exposures.

Subsequent events

Whether information received after the reporting date is reflected in the financial statements depends on whether it relates to asset-specific factual information or forecasting assumptions and, for forecasting assumptions, on additional considerations. See chapter 21 of KPMG Handbook, Credit impairment, for further discussion of how subsequent information is considered and, in particular, Question 21.2.10 for additional considerations related to forecasting assumptions.

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3.2.20 Estimating expected credit losses for AFS debt securities

An AFS debt security is impaired when its fair value declines below its amortized cost basis. Under Subtopic 326-30, credit losses are recognized when an impaired security is deemed uncollectible or when the company intends to sell (or will more likely than not be required to sell) the security before recovery of the amortized cost basis. [326-30-35-1, 35-2, 35-10]

In an economic downturn, there may be more circumstances when a security is impaired because its fair value has declined below its amortized cost basis (see also section 3.7).

For impaired securities, there may be more circumstances in which a company may have the intent to sell, or determine that it may be required to sell, an AFS debt security before recovery of the amortized cost basis in response to liquidity needs. The period before the security's forecasted recovery may be longer during periods of economic disruption, which increases the likelihood the company will be required to sell the security before recovery of the amortized cost basis. In these circumstances, companies must ensure that the appropriate writedowns are recognized.

For example, consider a situation in which Bank holds a large portfolio of debt securities classified as AFS for purposes of asset-liability management. Bank has a strategy of investing in low-risk, stable companies. However, recent economic disruption, caused by rising interest rates, restrictions in regional supply-chains, unstable governments and inflation, has impacted a number of the companies in which Bank is invested. Bank reevaluates its AFS portfolio and, following its own strategy, determines that it has the intent to sell the AFS debt securities held in the companies impacted by the economic disruption. Accordingly, Bank writes off any related allowance for credit losses and writes down the investments' amortized cost to fair value at the reporting date. Any incremental impairment is recognized in earnings.

Further, factoring in disruptive events may result in an increase in impaired AFS debt securities that are deemed uncollectible and/or an increase in the amount of the allowance for expected credit losses.

See chapter 19 of KPMG Handbook, Credit impairment, for further discussion of impairment of AFS debt securities.

3.3 Loan modifications – lender

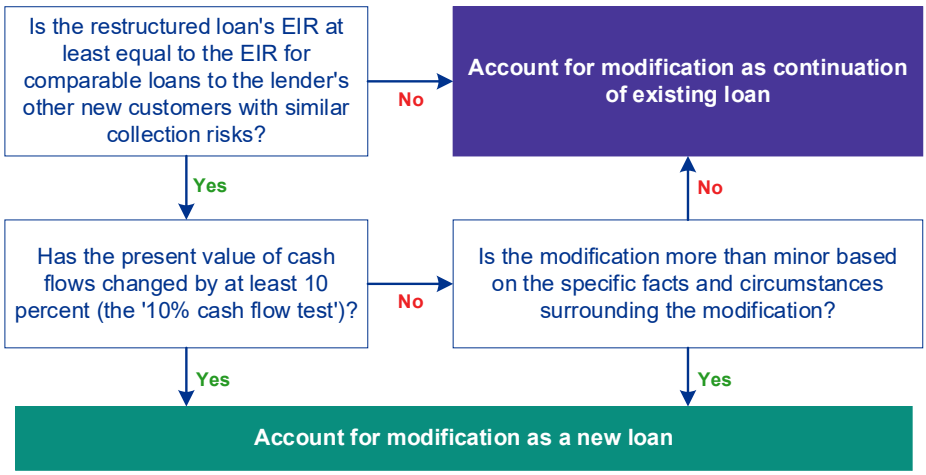
Economic disruptions may impact a borrower's ability to repay debt. As a result, lenders may grant payment holidays or other types of relief. Depending on the facts and circumstances of the transaction, lenders may need to consider:

- the accounting for loan modifications (see below);
- the estimate of expected credit losses (see section 3.3.10); and
- disclosure of information about certain modifications (see section 3.3.20).

Lenders must apply the loan refinancing and restructuring guidance in Topic 310 (receivables) to determine whether a modification results in a new loan or a

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continuation of the existing loan. Lenders evaluate how to account for modifications using the following decision tree.



The following table summarizes the accounting for a loan modification, depending on whether it is accounted for as a continuation of the existing loan or a new loan.

Continuation of existing loan	• Unamortized deferred fees and costs are carried forward in the amortized cost basis of the modified loan, along with any new fees received and direct costs associated with the restructuring.
New loan	• Unamortized deferred fees and costs associated with the original loan and any prepayment penalties are recognized in interest income. • A new loan is recognized.

3.3.10 Estimating expected credit losses

A lender does not include the impact of anticipated loan modifications (e.g. term extensions) in estimating expected credit losses. However, in making that estimate, the lender evaluates the credit risk of the loan portfolio, including whether there is additional credit risk associated with borrowers that are expected to receive modifications.

In periods of economic disruption, lenders may be experiencing higher rates of credit losses or may be modifying or restructuring loans at a higher rate or with different terms than in previous periods. In these cases, lenders need to update certain assumptions used in estimating expected credit losses to reflect current conditions.

See also section 3.2 about credit impairment for further discussion of assessing credit losses.

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3.3.20 Disclosures of certain loan modifications

Lenders that modify loans from borrowers experiencing financial difficulty are required to make disclosures when the modifications are in the form of principal forgiveness, interest rate reductions, other-than-insignificant payment delays or term extensions. A summary of the required disclosures is:

- the types of modifications used by the lender;
- the financial effect of modifications, by type of modification, including information about the changes to the contractual terms as a result of the modifications;
- loan performance in the 12 months after modification;
- qualitative information about how the modifications and the borrowers' subsequent performance are factored into determining the allowance for credit losses; and
- the amount of commitments, if any, to lend additional funds to borrowers experiencing financial difficulty that entered into a modification.

Various considerations are involved in determining whether the borrower is experiencing financial difficulty. Example considerations (not exhaustive) that the borrower may be experiencing financial difficulty are if it:

- is currently in payment default on any of its debt;
- has declared or is in the process of declaring bankruptcy; or
- would be unable to obtain funds from sources other than existing lenders at an EIR equal to the current market interest rate for similar debt for a nontroubled borrower.

3.4 Transfers between categories of debt securities

Investments in debt securities are classified as trading, AFS or HTM depending on the company's objectives, strategies and policies. [320-10-25-1]

Category	Description	Subsequent measurement
Trading	Debt securities that the company generally intends to sell in the near term.	Subsequently measured at fair value with changes in fair value included in earnings. [320-10-35-1]
HTM	Debt securities the company has the positive intent and ability to hold to maturity.	Subsequently measured at amortized cost, with disclosure of fair value in the notes to the financial statements. Credit impairment is recognized under the guidance in Subtopic 326-20 (see section 3.2.10). [320-10-35-1]
AFS	Debt securities not classified as either trading securities or as HTM securities.	Subsequently measured at fair value with changes in fair value included in other comprehensive

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Category	Description	Subsequent measurement
		income (and included in AOCI) until realized. Credit impairment is recognized under the guidance in Subtopic 326-30 (see section 3.2.20). [320-10-35-1]

While the initial classification is made at acquisition, it is reassessed at each reporting date to determine whether relevant facts and circumstances have changed. Although the initial designation as HTM is expected to be retained until the security is sold or matures, there may be circumstances that trigger a transfer out of this category. [320-10-35-5]

For example, in periods of economic disruption, companies may find:

- they no longer have the intent and ability to hold securities to maturity due to capital needs; or
- they need to shift their tax strategy for changes in tax laws due to economic disruption.

Except in limited situations, the sale or transfer of an HTM debt security before its maturity (or deemed maturity) calls into question, or taints, an investor's ability to hold securities to maturity that remain in the HTM category. Those limited situations are when the sale or transfer is in response to an event that: [320-10-25-6, 25-9, 25-10, 25-14]

- is provided a ‘safe harbor’ exemption specified in Topic 320; or
- is isolated, nonrecurring and unusual for the investor and could not have been reasonably anticipated.

Other than extremely remote disaster scenarios (e.g. a run on a bank or insurance entity), very few events would meet all four conditions in the last exception. To determine whether this exception applies, an entity evaluates the facts and circumstances of the event in relation to its own business.

Transfers into or from the trading category are rare. [320-10-35-12]

See chapter 4 of KPMG Handbook, Investments, for further discussion of debt security classification, how to determine if HTM classification is tainted by sale or transfer of HTM securities, and how to account for a transfer between classification categories.

3.5 Derivatives and hedging

Freestanding derivatives that are accounted for under Topic 815 (derivatives and hedging) are assets or liabilities that are recorded on the balance sheet at fair value, both initially and subsequently. How changes in fair value are accounted for depends on whether the derivative is designated as the hedging instrument in a qualifying hedging relationship. [815-10-05-4, 05-6, 25-1, 30-1, 35-1, 35-2]

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- **Nonhedging derivative** – Changes in fair value are reported in earnings.
- **Hedging derivative** – Accounting depends on the type of hedge (cash flow, fair value or net investment hedge) and the risk(s) being hedged.

To qualify for hedge accounting, an entity must meet certain criteria for the combination of the hedging instrument and the hedged item or transaction (the 'hedging relationship'). There are general criteria that apply to all types of hedges, and additional criteria that are specific to the type of hedge. Hedge accounting is elective and is permitted only for hedging relationships that meet all of the qualifying criteria. Therefore, if any eligibility criteria cease to be met, the hedging relationship must be discontinued.

During periods of economic disruption, the following may be impacted:

- whether a financial instrument or other contract is required to be accounted for as a derivative under Topic 815; and/or
- whether the criteria to qualify for hedge accounting continue to be met.

This section highlights examples of impacts that may be prevalent in a disruptive economic environment.

3.5.10 Scope of Topic 815

A derivative instrument is a financial instrument or other contract that meets the characteristics of a derivative under Topic 815. These characteristics are: [815-10-15-83]

Underlying + notional amount or payment provision	The financial instrument or other contract has both: • one or more underlyings; and • one or more notional amounts or payment provisions (or both).
Initial net investment	The financial instrument or other contract requires no, or a small, investment at inception of the contract – i.e. the initial net investment is zero, or smaller than would be required for other types of contracts expected to have similar responses to changes in market factors.
Net settlement	The financial instrument or other contract provides for net settlement because it: • requires or permits net settlement; • can be readily settled net by a means outside of the contract; or • provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement.

Certain items are excluded from Topic 815's scope even if they meet the definition of a derivative.

Whether a contract continues to meet the definition of a derivative and whether it is eligible for the normal purchases and normal sales scope exception are particularly relevant considerations during periods of economic disruption.

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Definition of a derivative

An entity is required to evaluate whether a financial instrument or other contract meets the definition of a derivative at inception and on an ongoing basis. As a practical matter, the ongoing reassessment primarily involves evaluating whether the net settlement characteristic is met because the other characteristics generally will not change over time.

During periods of economic disruption, a market mechanism may cease to exist after a contract's inception, or an asset to be delivered in settlement of a contract may cease being readily convertible to cash. These situations would result in the financial instrument or contract no longer being accounted for as a derivative instrument.

See section 3.6 of KPMG Handbook, Derivatives and hedging, for further discussion of the ongoing evaluation of whether the definition of a derivative is met.

Normal purchases and normal sales (NPNS) scope exception

Certain derivative instruments may qualify for the NPNS scope exception in Topic 815, provided certain criteria are met.

One criterion that must be met to apply the NPNS scope exception to a contract is that the company must conclude it is probable that the contract will result in physical delivery of the gross amount of the underlying. The company must reassess whether the contract continues to qualify for the NPNS scope exception when conditions change in a way that affects the likelihood that the contract will result in physical delivery and will not net settle. [815-10-15-23, 15-35, 15-39]

After certain disrupting events (e.g. natural disaster, government-imposed shutdown, imposition of sanctions or tariffs, regional conflict, terrorist attack), a company may conclude physical delivery is no longer probable because, for example, the company expects to cancel a transaction or because the counterparty may not be able to deliver the underlying.

When a derivative contract that was accounted for as a normal purchase or normal sale ceases to be eligible for the NPNS scope exception, the contract is accounted for as a derivative. That derivative is eligible to be designated as the hedging instrument in a hedging relationship.

In addition, when contracts designated as NPNS fail to result in physical delivery, an entity needs to consider whether similar contracts qualify as NPNS.

See section 2.4 of KPMG Handbook, Derivatives and hedging, for further discussion of the NPNS scope exception.

3.5.20 Hedge effectiveness

One of the general requirements that must be met for all hedges is that the hedging relationship is highly effective at managing the risk being hedged. Assessments of hedge effectiveness are required to be performed prospectively

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at hedge inception and both prospectively and retrospectively periodically thereafter (at least quarterly). [815-20-25-79]

Topic 815 requires the initial (prospective) assessment to be performed on a quantitative basis unless the hedging relationship meets certain conditions. Subsequent assessments may be performed on a quantitative basis, or on a qualitative basis if certain conditions are met. Additionally, Topic 815 provides three methods that allow an entity to assume a hedging relationship is perfectly effective if certain conditions are met.

Certain hedging relationships that have been highly effective in the past may be less effective in a disruptive economic environment. How current market conditions are considered in a company's assessment of hedge effectiveness depends on the type of hedging relationship and the company's method for assessing hedge effectiveness. The following table summarizes examples of considerations (not exhaustive) that may be particularly relevant in a disruptive economic environment.

Counterparty credit risk and entity's own nonperformance risk

All types of hedges require a company to consider whether developments in counterparty credit (and its own nonperformance) risk indicate the hedging relationship must be discontinued. The likelihood of a hedging relationship being significantly impacted may differ between those that have derivative hedging instruments that are exchange-traded or centrally cleared, and those that do not. Derivative instruments that are centrally cleared or exchange-traded are typically considered to have minimal credit (and nonperformance) risk because they generally have variation margin posted daily.

How counterparty credit (and the company's own nonperformance) risk impact an assessment of effectiveness depends on the type of hedge and, for fair value hedges, on the method of assessing effectiveness.

- **Fair value hedge – shortcut method.** Potential differences in credit risk between the derivative instrument and hedged item are generally ignored unless non-default by either party is no longer probable. When non-default is no longer probable, the company discontinues hedge accounting.
- **Fair value hedge – other methods.** Changes in counterparty credit risk and a company's own nonperformance risk on a derivative instrument's fair value are not likely to have an offsetting change on the change in fair value of the hedged item attributable to the hedged risk. As a result, a company's assessment of a hedging relationship's effectiveness may be impacted. Further, when the qualitative method is used to assess effectiveness, a qualitative-only assessment is not appropriate when there have been adverse developments in counterparty credit (or the company's own nonperformance) risk.
- **Cash flow hedge – all methods.** Counterparty credit risk or a company's own nonperformance risk are considered for both the derivative hedging instrument and the forecasted transaction. If it is no longer probable that the derivative counterparty or the company itself will not default, the company discontinues hedge accounting. Otherwise, changes in counterparty credit risk and a company's own nonperformance risk are ignored when assessing effectiveness.

Hedging relationships that are not perfectly effective

Some hedging relationships are not designed to be perfectly effective but nonetheless can be highly effective; for example, hedging relationships that include basis

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Hedging relationships that are not perfectly effective

differences or other critical terms that do not match (e.g. differences in notional amounts, maturities, payment dates, quantity, location, and delivery date). In periods of economic disruption, market conditions may cause the extent of offset to decrease for these relationships. This includes that it is possible that the extent of offset may decrease to the point that the relationship is no longer highly effective. Further, when the qualitative method is used to assess effectiveness, changes in facts and circumstances caused by economic events may result in a qualitative-only assessment not being sufficient. This is because a qualitative-only assessment is not appropriate when a company cannot reasonably support an expectation of high effectiveness.

Examples of relationships that are not perfectly effective and for which effectiveness may be decreased in a disruptive economic environment include the following.

- The hedged forecasted transactions in a cash flow hedge are interest payments on variable rate debt that contains a floor, and the hedging instrument is an interest rate swap that does not contain a floor. As interest rates fall, the potential impact of the floor on the hedged forecasted cash flows (interest payments) may become increasingly significant; however, there is no offsetting impact on the interest rate swap's cash flows.
- The hedged risk is one variable (e.g. a contractually specified interest rate in existing variable-rate debt), and the hedging instrument is a different variable (e.g. a different index on the variable leg of the interest rate swap designated as the hedging instrument).

See chapter 13 of KPMG Handbook, Derivatives and hedging, for further discussion of hedge effectiveness.

3.5.30 Modifications to the hedged item or transaction

An entity that modifies a hedged item or transaction is required to dedesignate (or partially dedesignate) a hedging relationship if the hedged item or transaction no longer meets the eligibility criteria or if the modification changes certain critical terms of the hedging relationship. [815-20-55-56, 815-25-40-1(a), 815-30-40-1(a)]

During periods of economic disruption, a company may modify the terms of the hedged item or transaction. For example, a company may modify a debt instrument (or the interest payments thereon) that is the hedged item or forecasted transaction(s) in a hedging relationship. If so, a determination is made regarding whether the hedging relationship must be terminated. That determination depends on the type of hedge (fair value or cash flow), how the hedged risk is specified in the hedge documentation, and the terms of the modification.

In all cases, the company evaluates whether the modification represents a change in the hedging relationship's critical terms. The following table summarizes relevant considerations when the hedging relationship's critical terms have or have not changed.

If the critical terms have changed	• The hedging relationship is required to be discontinued. • If all hedging criteria are met, the hedged item may be re-designated in a new hedging relationship.

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If the critical terms have not changed	The company considers the effect of the modification on the hedging relationship, such as whether it: • causes the hedging relationship to no longer be highly effective (see section 3.5.20); or • results in forecasted transactions in a cash flow hedge (i.e. interest payments) no longer being probable within the specified hedge period (see section 3.5.40). In either of these cases, the hedging relationship is generally required to be discontinued.

See section 6.10 of KPMG Handbook, Derivatives and hedging, for further discussion of changes in the critical terms.

3.5.40 Cash flow hedges

Probability of hedged forecasted transaction

For cash flow hedge accounting to be appropriate, a company must conclude it is probable that a forecasted transaction will occur within the timeframe specified at hedge inception. When a company can no longer support this assertion, it discontinues hedge accounting for that transaction. [815-20-25-3, 25-15]

After a hedging relationship is discontinued, if a company determines it is probable that the previously hedged forecasted transaction will not occur within the initially specified timeframe or an additional period of time, it must reclassify deferred gains or losses on the related hedging derivatives from AOCI to earnings. Further, a pattern of reclassifying amounts from AOCI to earnings due to missing forecasts may call into question a company's ability to predict future transactions and use cash flow hedge accounting in the future for similar forecasted transactions. [815-30-40-4 – 40-6]

Uncertainty caused by disruptive economic conditions – including the company's consideration of the counterparty's credit (and its own nonperformance) risk – may make it difficult for a company to assert that a transaction will occur, or what its timing or terms will be. Examples include the following.

- A company may need to cancel or delay planned transactions such as expected purchases or sales of nonfinancial items due to factory shutdowns, curtailment of the workforce or customer cancellations.
- A company may need to cancel or delay previously expected issuances of debt due to market conditions.

In these and similar situations, the company may need to discontinue hedge accounting and determine whether to immediately reclassify amounts from AOCI to earnings (and, if so, consider the impact on other cash flow hedging relationships).

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See the following of KPMG Handbook, Derivatives and hedging:

- chapter 9 for further discussion of the qualifying criteria for cash flow hedges, including assessing the probability of the forecasted transaction occurring; and
- chapter 10 for further discussion about accounting for cash flow hedges, including when it is probable a forecasted transaction will not occur.

Net loss on derivative is reported in AOCI

Ordinarily, losses on derivatives used as cash flow hedging instruments are deferred in AOCI until the forecasted hedged transaction affects earnings. More specifically, a net derivative loss in AOCI represents an amount that is expected to offset a future gain. However, when a net loss is expected to result from the combination of the derivative and the hedged transaction (and the related asset acquired or liability incurred) in future periods, that amount is immediately reclassified into earnings. [815-30-35-40, 35-41]

In periods of economic disruption, market prices might fall to the point that there are no longer anticipated revenues (gains) being offset by the loss in AOCI, resulting in a need to immediately reclassify the amount that is not expected to be recovered from AOCI into earnings.

See section 10.3.10 of KPMG Handbook, Derivatives and hedging, for further discussion of accounting for cash flow hedges when it is probable a forecasted transaction will not occur.

3.5.50 Fair value hedges

Unrecognized firm commitments are eligible to be designated as the hedged item in a fair value hedge. A firm commitment is a (legally) binding agreement between unrelated parties that specifies all significant terms and includes a disincentive for nonperformance that is sufficiently large to make performance probable. [815-20-25-12, 815-20 Glossary]

If the hedged item later ceases to meet the definition of a firm commitment (e.g. because performance is no longer probable), the hedging relationship is discontinued, and any asset or liability recognized as a result of the hedging relationship is recognized in earnings immediately. This is because the firm commitment no longer exists. A pattern of discontinuing hedge accounting of firm commitments may call into question a company's ability to apply hedge accounting for future firm commitments. [815-25-40-5, 40-6]

Uncertainty caused by disruptive economic conditions – including the company's consideration of the counterparty's credit (and its own nonperformance) risk – may impact a company's assessment of whether performance is probable. When performance is no longer probable, the company discontinues hedge accounting, immediately recognizes in earnings any asset or liability recognized as a result of the hedge, and considers the impact on other hedges of firm commitments.

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We believe a company should consider all relevant facts and circumstances when determining whether it is appropriate to apply hedge accounting for future firm commitments when the company discontinues those types of hedging relationships due to economic disruption.

See the following of KPMG Handbook, Derivatives and hedging:

- chapter 7 for further discussion of qualifying criteria for fair value hedges, including firm commitments; and
- chapter 8 for further discussion of accounting for fair value hedges of firm commitments.

3.6 Equity securities

3.6.10 Overview

Investments in equity securities and other ownership interests in an entity are accounted for under Topic 321 unless excluded from its scope (e.g. investments that are subject to derivative accounting or accounted for under the equity method). Under Topic 321, equity securities are categorized and measured as follows. [321-10-15-2 – 15-5, 35-1 – 35-2]

Category	Measurement
• **With a readily determinable fair value; or** • **Without a readily determinable fair value when measurement alternative is not elected**	• Initial measurement at transaction price or fair value • Subsequent changes in fair value reported in earnings
• **Without a readily determinable fair value when measurement alternative is elected**	• Initial measurement at cost • Subsequent measurement at cost minus impairment, if any, plus or minus changes in fair value when there are observable prices

A company evaluates whether an equity security has a readily determinable fair value at each reporting period. The effects of economic disruption could result in an equity security no longer having a readily determinable fair value. [321-10-35-2]

See chapter 5 of KPMG Handbook, Investments, for further information on accounting for investments in equity securities, including determining whether equity securities have readily determinable fair values.

3.6.20 Equity securities without a readily determinable fair value when measurement alternative is elected

Topic 321 permits companies to subsequently measure equity securities without readily determinable fair values using a measurement alternative. Under this alternative, such an equity security is measured at cost minus impairment, if any, plus or minus changes in fair value when there are observable price changes in orderly transactions for the identical or a similar security of the same

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issuer. When an observable price is identified, the security is remeasured to fair value with changes in fair value recognized in earnings. [321-10-35-2]

An equity security without a readily determinable fair value is impaired if its fair value is less than its carrying amount. Declines in equity markets may result in increased potential for impairment. Topic 321 requires companies to make a qualitative assessment considering impairment indicators when evaluating whether the fair value of an investment is less than its carrying amount (i.e. whether the security is impaired). These impairment indicators include, but are not limited to: [321-10-35-3]

- a significant adverse change in the economic environment of the investee; and
- a significant adverse change in the general market condition of either the geographical area or the industry in which the investee operates.

If the qualitative assessment indicates the investment is impaired or the company cannot determine qualitatively that the investment is impaired, the company measures the fair value of the investment at the reporting date. If the fair value is determined to be less than the carrying amount, the company recognizes the difference as an impairment loss. [321-10-35-2]

In economic downturns, one or more qualitative impairment indicators are likely to be present, and we expect that, in most cases, companies will not be able to determine qualitatively that the security is not impaired. As a result, we expect that, in most cases, the fair value of these investments will need to be measured at the reporting date.

Topic 321 requires a company to make a reasonable effort, without expending undue cost and effort, to identify observable price changes that are known or that can be reasonably known. Even in periods of economic downturn and market volatility, a company does not disregard observable prices identified unless those prices are from transactions determined to be not orderly. [321-10-55-8]

For further discussion of measuring equity securities that do not have readily determinable fair values and fair value measurements, see KPMG Handbook, Investments, and KPMG Handbook, Fair value measurement, respectively.

3.7 Fair value measurement

Periods of economic disruption and uncertainty may pose unique challenges when determining many of the inputs used in fair value measurements of financial assets.

For example, there may be a significant decrease in the volume or level of activity in the market for an item compared to normal market activity. If an entity 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.

A decrease in the volume or level of activity on its own might not indicate that a transaction or quoted price is not representative of fair value, or that a

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transaction in that market is not orderly. In addition, it is not appropriate to presume that all transactions in a market in which there has been a decrease in the volume or level of activity are not orderly. Judgment may be required in determining whether, based on the evidence available, a transaction is not orderly. Entities must not disregard market prices unless those prices are from transactions determined to be disorderly.

The volume or level of activity in the market for a financial asset is only one of the many inputs used in measuring its fair value. For an in-depth discussion of how to measure fair value under Topic 820, including discussion about orderly transactions and inactive markets, see KPMG Handbook, Fair value measurement.

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4. Inventory

Detailed contents

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4.2 Overview

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4.4 Impairment

4.5 Purchase commitments

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4.1 Questions to ask

In periods of economic disruption, inventory values may be impacted by events and conditions such as changes in customer demand, product pricing and government trade policies (e.g. tariffs, export controls), as well as the disruption to manufacturing, workforce and supply chain capabilities. Inventory in areas impacted by events such as natural disasters or global conflict may be destroyed or become inaccessible.

The following are example questions to consider that are specific to economic disruption and the potential impact to inventory and associated accounts (not exhaustive).

QUESTION	ADDITIONAL INFORMATION
Have inventoriable costs been affected by: • a change in the level of production at a facility; • wasted material or unanticipated spoilage; or • new tariffs?	Section 4.3
Has an impairment of inventory occurred for reasons such as (not exhaustive): • decreases in estimated selling prices, or market values (as applicable); • increases in acquisition or production costs; • increases in reasonably predictable costs of completion, disposal or transportation; or • damage, deterioration or obsolescence? If an impairment has occurred in an interim period, could it be temporary?	Section 4.4
Are there any unhedged and noncancellable commitments to purchase inventory?	Section 4.5

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4.2 Overview

The primary measurement basis for accounting for inventory is cost. As applied to inventories, cost means, in principle, the sum of the applicable expenditures and charges directly or indirectly incurred in bringing an article to its existing condition and location. It is understood to mean acquisition and production costs, and its determination involves many considerations. [330-10-30-1]

The ending inventory cost is determined using specific identification; average cost; first-in, first-out (FIFO); last-in, first-out (LIFO); or the retail inventory method (RIM). Depending on the nature of the cost methodology used, impairment of inventory is determined using either the lower of cost or market (LCM) method or the lower of cost and net realizable value (NRV) method. [330-10-35-1A – 35-1C]

While the overarching principle of accounting for inventory is seemingly simple, the application of this principle becomes increasingly complicated depending on the nature of the inventory (e.g. work-in-progress (WIP), finished goods) and the multiple considerations in Topic 330 in determining the appropriate allocation of costs and charges. The accounting considerations can be further complicated in periods of economic disruption. [330-10-30-2]

4.3 Inventoriable costs

Inventory costs include acquisition costs and production costs (i.e. costs to convert materials into WIP or finished goods), which may be directly impacted by unplanned disruptions. If a company is unable to meet planned production targets due to events or circumstances such as a natural disaster or prolonged supply chain issues then further consideration of the direct and/or indirect costs may be needed. [330-10-30-1]

Normal production levels

Fixed overhead costs are allocated to inventory based on the ‘normal’ capacity of the production facility. Normal capacity is the production expected to be achieved over a number of periods under a company’s normal circumstances. It is typically expressed as a range of production levels to account for expected variations in production levels from period to period – e.g. loss of capacity resulting from planned maintenance that may only occur in certain specified periods. Judgment is required in determining the range of normal capacity. [330-10-30-3 – 30-4]

Following are some factors related to economic disruption that may result in production levels that are not within the range of normal capacity (not exhaustive).

Factors driving abnormally low production include:

- reduced demand for goods;
- material shortages and other supply chain issues;
- increased labor costs;

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- production slowdowns due to global trade policies (e.g. increased tariff exposure or new export controls); and
- unplanned facility downtime.

Factors driving abnormally high production include:

- increased demand for specific goods depending on the nature of the disruption; and
- temporary increase as a precautionary measure to mitigate the risk of supply chain disruptions, increased costs or limited availability of raw materials.

A company adjusts the allocation of costs to inventory if production levels are not within the established range of normal capacity. [330-10-30-3]

The range of normal capacity will vary based on business- and industry-specific factors. However, whether an adjustment is made depends on the nature of the variation. [330-10-30-4, 30-6, 30-7]

- If production is abnormally high, the fixed overhead allocated to each unit of production is reduced.
- If production is abnormally low, no adjustments are made to the fixed overhead allocations, and unallocated overhead is expensed in the period incurred.

See Questions 3.2.110 and 3.2.120 and Example 3.2.05 of KPMG Handbook, Inventory, for further discussion of normal production levels and unallocated fixed overhead.

Other abnormal costs

In periods of economic disruption, there may be increases to certain costs. Abnormal costs, including amounts of wasted materials or unanticipated spoilage, are treated as current period charges and not allocated to the cost of inventory. [330-10-30-7]

The following are potential abnormal costs that a company may incur in a period of economic disruption (not exhaustive): [330-10-30-7]

- additional warehousing expense for rental of alternative storage facilities due to a natural disaster; and
- additional spoilage due to an unexpected shut down of a facility/warehouse or disruption of manufacturing or shipment logistics.

If management determines these costs are abnormal, the company expenses them in the period incurred.

We believe an increase in direct acquisition costs, such as incurring higher costs when acquiring inventory because of new or additional tariffs, does not typically represent abnormal costs.

See Question 3.2.120 and Example 3.2.10 of KPMG Handbook, Inventory, for further discussion of abnormal costs.

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Standard costing

Companies that use standard costing for determining inventory and product costs should evaluate their purchase price, wage rate, usage or efficiency variances at the end of an interim period. Variances that are planned and expected to be absorbed by the end of the annual period are ordinarily deferred at interim reporting dates. However, if the cost variances are unplanned or unanticipated, they are recorded at the interim reporting date in the same manner they would be at the end of an annual reporting period – i.e. expense or capitalize as appropriate. [270-10-45-6(d)]

See Questions 3.3.20 and 3.3.280 of KPMG Handbook, Inventory, for further discussion of standard costing approaches.

Tariffs

Companies doing business internationally may experience economic disruption in the form of unexpected or increased tariffs. Tariffs may depend on a product's classification, country of origin, value and any applicable exceptions. Determining applicable tariffs can be complex, particularly in jurisdictions with evolving trade policies. These costs are capitalized if incurred in procuring the goods required to bring the inventory to its existing condition and location (e.g. inbound to the manufacturing facility or fulfillment center). The additional costs may affect a company's impairment analysis. See section 4.4. [330-10-30-1]

See Question 3.2.20 of KPMG Handbook, Inventory, for further discussion of tariffs and other import fees.

Temporary LIFO liquidation

Some companies with supply chain issues may encounter potential liquidations of one or more LIFO layers in an interim period. If those LIFO layers are expected to be replaced by the end of the annual period, the inventory at the interim reporting date does not reflect the LIFO liquidation and cost of sales for the interim reporting period includes the expected cost of replacement of the liquidated LIFO base. Significant judgment may be required to evaluate replacement costs and LIFO layers for a company whose supply chain has been significantly disrupted and where uncertainty remains. [270-10-45-6(b)]

The cost of replacement related to a temporary LIFO liquidation is recorded on the balance sheet as either: [LIP.8-9, 8-14]

- a deferred credit, with inventory reflecting the liquidation; or
- a credit to inventory.

See Questions 3.3.240 and 3.3.250 of KPMG Handbook, Inventory, for further discussion of temporary LIFO liquidations.

4.4 Impairment

In periods of economic disruption, there may be events and conditions that increase the risk an impairment has occurred. Regardless of the industry, all inventory not sold or otherwise disposed of at the end of the reporting period is

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tested for impairment to determine if evidence exists to indicate the value of inventory is less than its carrying amount.

The nature and extent of the events and conditions could be specific to each company. For example, a manufacturer of fresh food products experiencing shipping constraints due to supply chain disruptions may consider spoilage or other adjustments to its inventory balances earlier than a company that manufactures construction materials.

Lower of cost and NRV – inventory measured using a method other than LIFO or RIM

Inventory measured using any method other than LIFO or RIM (e.g. FIFO, weighted average) must be written down to the lower of cost and NRV. NRV is the estimated selling price of the inventory in the ordinary course of business less reasonably predictable costs of completion, disposal and transportation.

Economic disruption may cause decreases in the net realizability of inventory. Tariffs and related cost increases may lead to higher inventory costs without corresponding increases in selling prices. In addition, significant or abrupt changes in demand may cause losses to inventory – in particular, inventories with a short shelf life (e.g. perishable inventory) or inventories for which there is significant stock on hand that surpasses current demand expectations. Companies may need to lower their selling prices to increase customer demand while simultaneously addressing supply chain, manufacturing and transportation disruptions that may increase the costs to complete and transport inventories. These effects would reduce the net realizability of inventory.

If a company stockpiles inventory in anticipation of increased costs (e.g. due to new or increased tariffs), there may be a risk of excess or obsolete inventory. Overstocking can result in having more inventory than can be sold within a reasonable period, and inventory may become obsolete due to changes in technology, market preferences or other factors. These effects would also reduce the net realizability of inventory.

See section 4.4.10 of KPMG Handbook, Inventory, for further discussion of lower of cost and NRV.

Lower of cost or market – inventory measured using LIFO or RIM

Inventory measured using LIFO or RIM is tested for impairment using the lower of cost or market method. This means inventory is impaired when its market value is less than its carrying amount. Market represents current replacement cost, which is the cost to purchase or reproduce the inventory. [330-10-35-1C]

The lower of cost or market method may be affected by the same economic disruptions noted above for the lower of cost and NRV method. Determining the replacement cost may present challenges in periods of economic disruption due to supply chain, manufacturing and/or workplace issues. In addition, changing prices, damage, physical deterioration or obsolescence may complicate the determination of market value. [330-10-35-4]

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See section 4.4.20 of KPMG Handbook, Inventory, for further discussion of the lower of cost or market method.

Temporary impairments during an interim period

Topic 270 permits a company to not recognize an impairment in an interim period if the decline in market value or NRV can be reasonably expected to be restored in the same fiscal year. We believe that if a company has substantial evidence that the decline is temporary and that the market value or NRV will recover before the inventory is sold (e.g. seasonality), an impairment is not recorded. However, a company does not defer inventory losses from market declines beyond the interim period in which the decline occurs if a near-term price recovery is uncertain. [270-10-45-6(c), 330-10-55-2]

It may be difficult to obtain substantial evidence related to market value or NRV recoveries in periods of economic disruption that lead to significant market uncertainty (e.g. recessionary periods, periods of deflation, changing consumer behavior due to an event such as a stay-at-home order).

See section 4.5 of KPMG Handbook, Inventory, for further discussion of impairments during interim periods.

4.5 Purchase commitments

Disruption to global trade and market demand could cause inventoriable costs to increase or customer prices to decline, thereby triggering losses from firm, noncancelable and unhedged commitments for the future purchase of inventory. A company that enters into purchase commitments with suppliers will need to evaluate whether it has incurred a loss on these purchase commitments and, if so, accrue that loss. No loss is recorded if there are firm sales contracts for the future inventory. However, companies with firm sales contracts will need to consider the nature of those contracts in periods of economic disruption and whether price or other concessions are likely to be granted to customers. For example, if new or additional tariff costs are expected to be incurred related to purchase commitments, the pricing of related firm sales contracts should be evaluated, including whether the company has the ability to pass on the cost of tariffs to customers. [330-10-35-17 – 35-18]

See section 4.6.40 of KPMG Handbook, Inventory, for further discussion of purchase commitments.

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5. Goodwill and indefinite-lived intangibles

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5.1 Questions to ask

The recoverability of goodwill and indefinite-lived intangible assets is susceptible to various forms of economic disruption. These disruptions may arise from events or circumstances not always in management's control and may be a result of macroeconomic conditions or geopolitical turmoil. Identifying these situations timely is important, not only so that these assets can be accounted for properly (e.g. assessed for impairment) but also so that financial statement users can be appropriately informed of any changes to the projected future benefit associated with these assets.

The following are example questions to consider that are specific to economic disruption and the potential impact to goodwill and indefinite-lived intangible assets and associated accounts (not exhaustive).

QUESTION	ADDITIONAL INFORMATION
Has an impairment trigger been identified related to: • reduced demand for goods and/or services; • increased costs to produce or provide goods and/or services; • increased borrowing costs impacting the ability to achieve growth; or • other indicators that goodwill and/or other indefinite-lived intangibles are more likely than not impaired?	Section 5.2
Has the likelihood of passing the optional annual qualitative impairment assessment (Step 0) decreased such that performing that assessment is no longer prudent because, for example, economic disruption has negatively impacted: • forecasted financial information (e.g. anticipated downward changes to forecasted demand or upward changes to forecasted costs); • the predictive value of historical performance; • the cost of capital or the share price; or • the sufficiency of the size of the cushion in the last quantitative test results?	Section 5.4
Have the following impacts to the qualitative and/or quantitative impairment tests been considered: • changes in interest rates (e.g. the discount rate used in a valuation model); • anticipated changes in forecasted financial information; and/or • significant volatility in the company's share price?	Sections 5.4 and 5.5

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QUESTION	ADDITIONAL INFORMATION
Do the company's disclosures appropriately communicate (if applicable): • for public business entities only, the existence of impairment indicators that have not but could lead to an impairment charge in future reporting periods; or • for all entities, a current period impairment charge?	Section 5.6

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5.2 Triggering events

Overview

Goodwill and indefinite-lived intangible assets are tested for impairment on an annual basis or more frequently if events occur or circumstances change to indicate they are more likely than not impaired (i.e. a triggering event). Topic 350 includes examples of triggering events and circumstances, while also acknowledging that the list is not exhaustive. Many of these triggering events, and others, can occur because of economic disruption. [350-20-35-3C, 35-3F, 350-30-35-18B – 35-18C]

The following are potential triggering events resulting from economic disruptions that may indicate it is more likely than not that goodwill and/or indefinite-lived intangible assets are impaired (not exhaustive). [350-20-35-3C, 35-3F, 350-30-35-18B – 35-18C]

Potential triggering events

- Reporting unit(s) with significant operations in areas of significant disruption
- Permanent or temporary curtailment of operations due to pandemic or geopolitical instability
- Impact of restrictive regulation (e.g. economic sanctions) imposed on countries significant to the operation of the company or other relevant regulatory or political developments
- New or increased tariffs (or other trade-related costs such as new taxes) that significantly affect input costs or customer demand, or give rise to operational or supply chain disruptions
- Supply chain disruptions such that the company cannot procure raw materials or components for finished goods
- Logistical or other disruptions causing a decline in the company's ability to ship product to or from the affected markets
- Volatility in commodity prices or foreign exchange rates that are expected to negatively impact revenues or production costs
- A decline in market-dependent multiples or metrics (absolute terms and/or relative to peers)
- A change in the market demand for a company's products or services
- More-likely-than-not disposition of all or a portion of a reporting unit
- Workforce limitations that have impeded the company's ability to manufacture products or provide services to customers, including changes in management or other key personnel
- A sustained decrease in share price (absolute terms and relative to peers)
- A change in the company's strategy or customer base
- A deterioration in the ability to access capital through the equity and credit markets
- Negative or declining cash flows or a decline in actual or planned revenue or earnings compared with actual and projected results of relevant prior periods
- Contemplation of bankruptcy
- Litigation

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Once a triggering event has been identified and goodwill and/or indefinite-lived intangible assets are deemed more-likely-than-not impaired, a company performs a quantitative test for impairment (i.e. determines if the fair value of the goodwill's reporting unit or the indefinite-lived intangible asset is less than its carrying value).

For a general discussion about identifying triggering events, see section 4.3 of KPMG Handbook, Impairment of nonfinancial assets.

Rising inflation

When there has been a rise in inflation over a period of years, the effects of inflationary factors may need to be considered in a company's impairment assessment. Some effects that may impact the fair value of an indefinite-lived intangible asset or reporting unit include:

- the inability to pass on increased costs to customers;
- decreases in customer demand;
- increased sensitivity to inflationary factors due to low cushion between carrying amounts and fair values;
- consequential impacts of fiscal policy to manage inflation, such as increased interest rates; and
- the inability to meet forecasted growth due to an increase in the cost of capital.

However, the mere presence of inflation does not necessarily indicate a long-term issue. It is important to have an appropriate understanding of the potential impacts of both inflation and other fiscal initiatives (such as increased borrowing rates or the cost of capital) on the operations and value of the business.

Inflation may cause a wide range of disruption and potential triggering events. Therefore, companies must have appropriate processes and related controls (if required) in place to identify and evaluate the potential impacts.

Increasing discount rates

Companies that recently entered into a business combination using a discount rate lower than the current rate should carefully evaluate whether a triggering event has occurred if:

- the acquiree is its own (or substantially its own) reporting unit;
- the reporting unit had a low amount of cushion prior to the increase in the discount rate; or
- the acquisition includes indefinite-lived intangible assets.

For a general discussion about identifying triggering events, see section 4.3 of KPMG Handbook, Impairment of nonfinancial assets. For a discussion of fair value measurement, see chapter 8 of KPMG Handbook, Impairment of nonfinancial assets, or KPMG Handbook, Fair value measurement.

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5.3 Unit of account

Goodwill

Generally, reporting units are expected to remain consistent unless there is a change to the internal reporting structure or other changes in the business. When there has been a revision of reporting units, companies must carefully consider whether there is an indicator of impairment that would require impairment testing. Goodwill may also need to be reassigned following a reorganization, which is generally done using relative fair values.

See section 5.2 and Questions 4.3.110 and 5.4.130 of KPMG Handbook, Impairment of nonfinancial assets, for details and examples related to revising reporting units.

Indefinite-lived intangible assets

Unlike goodwill, which is tested at the reporting unit level, indefinite-lived intangible assets are generally tested individually. Therefore, in periods of economic disruption, a company considers the impact of the issues and circumstances on the value of these assets individually, in addition to reporting units and asset groups. For example, intangible assets such as customer relationships and trade names may lose value if growth prospects diminish or if the company's financial performance is expected to decline.

For detailed considerations related to assessing impairment of indefinite-lived intangible assets, see section 8.5 of KPMG Handbook, Impairment of nonfinancial assets.

5.4 Qualitative assessment

Many companies perform an optional qualitative assessment as part of the annual impairment testing requirements. However, even if a company has performed a qualitative assessment in past years, it need not necessarily perform a qualitative assessment in the current year.

In determining whether to perform a qualitative assessment in the current year, a company may need to consider different factors or adjust other assumptions used in prior-year qualitative tests to account for economic disruption. Depending on a company's facts and circumstances, the likelihood of the qualitative test resulting in a more-likely-than-not conclusion that the carrying value is greater than fair value (thereby requiring a quantitative test) may be higher in periods of economic disruption or elevated uncertainty.

Economic disruption may affect and result in the following, which are considered when determining whether to perform a qualitative assessment in the current year (not exhaustive).

Forecasted financial information	• Projected financial information that is less predictable due to economic disruption • Anticipated downward changes to forecast

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Inflationary cost factors	• Inflationary considerations (such as margin erosion) not factored into prior-year qualitative or quantitative tests that may impact the current year impairment conclusion
Cost of capital	• Increases in the cost of capital that have the potential to reduce the fair value of a reporting unit as compared to the prior year through an increased discount rate • Higher borrowing costs that may slow the ability for a company to grow – requires considering the likelihood of prior-year anticipated expansion plans
Share price	• The underlying reasons behind a company's share price trending downward and its impact on estimated fair value
Size of cushion in last quantitative test	• Economic disruption experienced in periods subsequent to the last quantitative test may indicate that a smaller cushion may be more likely to show erosion in a quantitative test.

Companies should document relevant considerations when a qualitative test is determined to be appropriate.

See chapter 6 of KPMG Handbook, Impairment of nonfinancial assets, for a discussion of the qualitative assessment.

5.5 Quantitative assessment

When a company tests goodwill and indefinite-lived intangible assets for impairment in periods of economic downturn or disruption (either due to a triggering event or while performing its annual test), there may be unique factors to consider when performing the quantitative assessment. These factors may relate to the inputs used in the quantitative impairment model (e.g. the discount rate), or they may extend to the accuracy of the estimates used in the models (e.g. projected financial information).

Discount rate

The discount rate used in the quantitative impairment assessment is sensitive to various external factors, such as the consequential impact of inflation on the risk-free borrowing rate (see below), as well as company-specific risk conditions. These components of the overall discount rate need to be carefully analyzed because any change in the discount rate could alter the impairment conclusion.

Historically, the US Federal Reserve has used central bank interest rates to address rising inflation. Risk-free rates increase correspondingly. When risk-free rates rise, the discount rates used in valuations generally also increase, thereby reducing the discounted cash flows in an income approach valuation and the fair value of the reporting unit or indefinite-lived intangible asset, even if the projected undiscounted cash flows have remained consistent.

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See section 8.3.50 of KPMG Handbook, Impairment of nonfinancial assets, for a discussion of discount rates.

Projected financial information

When economic conditions are distressed, it may be necessary to adjust previous assumptions used in financial projections, such as sales growth, labor costs and capital spending (among others). These adjustments should be reflective of the facts and circumstances existing as of the evaluation date. Further deterioration of financial performance in future reporting periods may result in additional adjustments to the assumptions used in the impairment testing for those reporting periods.

Required adjustments can be incorporated into projected financial information using one of two approaches, which are theoretically expected to yield comparable outcomes.

- **Single cash flow approach (or 'traditional approach'):** This method uses a single, most likely set of projected financial information.
- **Scenario analysis or expected cash flow approach:** This method involves preparing multiple sets of projected financial information and applying probability weighting to the scenarios.

Although the traditional approach is more common, in periods of economic disruption or heightened uncertainty, a scenario analysis approach may be more appropriate. This is particularly true when downside scenarios are more likely and/or more severe, or when there are distinct outcomes that the traditional approach may not adequately capture.

See section 8.3.50 of KPMG Handbook, Impairment of nonfinancial assets, for a discussion of financial projections.

Market multiples

Companies measuring the fair value of a reporting unit using the guideline public companies method should be cautious about using observable forward multiples in distressed markets and should perform additional due diligence to assess the multiples' reasonableness. In particular, the date of the estimates and how the estimates have been updated should be confirmed.

See section 8.3.40 of KPMG Handbook, Impairment of nonfinancial assets, for a discussion of market multiples.

Market participant acquisition premium (MPAP)

In a distressed market, volatility is generally higher and market capitalizations tend to be lower; consequently, MPAPs generally increase as compared to historical premiums.

Determining a reasonable MPAP in a distressed market requires:

- additional judgment; and
- consideration of the entity's specific facts and circumstances and available comparable transactions.

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As a result, more time will likely be spent supporting an MPAP in a distressed market.

See section 8.3.40 of KPMG Handbook, Impairment of nonfinancial assets, for a discussion of MPAPs.

Market capitalization reconciliation

The reconciliation of the fair value of a company's reporting units to its market capitalization is frequently used to evaluate the reasonableness of the fair value assigned to the company as a whole. This may be challenging to analyze in periods of economic or market volatility because a company's share price may fluctuate significantly due to external pressures outside of management's control.

However, while the markets are generally considered orderly, it may be appropriate for management to consider the market capitalization based on an average share price over a reasonable period as a better estimate of the fair value if the company is experiencing market volatility. Generally, the reasonable period used in averaging the share price will precede and lead up to, but not extend beyond, the measurement date. Changes in market prices after the measurement date are not considered in determining average market prices because they do not reflect conditions on that date.

The length of the averaging period will depend on company-specific facts and circumstances. Regardless, the averaging range selected must be supported and not chosen to avoid an impairment.

For a general discussion of market capitalization reconciliation, see section 8.3.70 of KPMG Handbook, Impairment of nonfinancial assets.

Goodwill impairment tax implications

Entities measure impairment using the difference between the carrying amount and the fair value of the reporting unit. The tax benefit of the impairment charge related to first component financial statement goodwill either creates a deferred tax asset or reduces an existing deferred tax liability, which increases the carrying amount of the reporting unit above its fair value. To address this additional impairment, Subtopic 350-20 (goodwill) requires an entity to calculate its recognized impairment loss and associated deferred tax effect using the same simultaneous equation used in business combinations.

For a discussion of the income tax implications related to goodwill impairment, including the simultaneous equation, see sections 6.015 and 10.019 of KPMG Handbook, Accounting for income taxes.

5.6 Impairment disclosures

US GAAP requires a company to disclose the facts and circumstances that lead to an impairment when it occurs during the reporting period. Additionally, public companies are required to disclose additional information when the facts and

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circumstances are such that an impairment has not occurred but may occur in the near future (i.e. early warning disclosures) (see below).

For a discussion of impairment disclosure requirements for both public and private companies, see chapter 10 of KPMG Handbook, Impairment of nonfinancial assets.

Early warning impairment disclosures

A public company is required to 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 are required and generally would be expected to be disclosed in periods in advance of the charge. [Reg S-K Item 303(b)(2)(ii)]

The SEC staff has stated that it focuses on disclosures included in Management's Discussion and Analysis (MD&A) associated with goodwill impairment testing. The SEC staff has also discussed its expectation regarding the types of disclosures to be included in MD&A. [2009 AICPA Conf]

In addition, Topic 275 (risks and uncertainties) requires that the company disclose in its financial statements events or circumstances that could significantly affect the amounts that are reported in the financial statements. [275-10-50-8, 50-13]

For example, if a company has a reporting unit that is at risk of failing a future quantitative goodwill impairment test, and an impairment of goodwill allocated to that reporting unit could be material, the SEC staff would expect that company to highlight the risk of impairment in the notes to its financial statements as well as MD&A. Further, if the fair value of a reporting unit as of the date of the last impairment test is not substantially more than its carrying amount, the SEC staff expects the company to disclose:

- the percentage by which the fair value of the reporting unit exceeds its carrying amount;
- the amount of goodwill allocated to the reporting unit;
- a discussion of the assumptions used and any uncertainty inherent in those assumptions; and
- a discussion of the potential events and circumstances that could have a negative effect on the assumptions.

For a discussion of impairment disclosures, see chapter 10 of KPMG Handbook, Impairment of nonfinancial assets.

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6. Long-lived assets, leases and equity method investments

Detailed contents

Item significantly updated in this edition #

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6.1 Questions to ask

Long-lived assets, leases and equity method investments may be impacted by various forms of unforeseen or sudden economic disruption. Long-lived assets and leases are critical to operations, and how they are impacted may send a signal to financial statement users about the state of a company's current operations and potential future prospects. In addition, how equity method investments are impacted may raise questions of impairment among the financial statement users. Given these impacts, and the signals/questions they may raise, it is imperative for management to understand the accounting implications of economic disruption on these assets.

The following are example questions to consider that are specific to economic disruption and the potential impact to long-lived assets, leases, equity method investments and associated accounts (not exhaustive).

QUESTION	ADDITIONAL INFORMATION	
Long-lived assets		
Does a substantial decline in share price indicate a long-lived asset or asset group may not be recoverable or do any impairment triggering events exist related to a long-lived asset or asset group?	Section 6.2.10	
Has the composition of the company's asset groups changed?	Section 6.2.10	
Are insurance recoveries related to the effects of economic disruption (e.g. property damage, business interruption) expected or have they already been received?	Section 6.2.20	
Have the estimated useful lives of any long-lived assets changed?	Section 6.2.30	
Are there plans to abandon or idle any long-lived assets, or has abandonment or idling already occurred?	Section 6.2.40	
Are there plans to sell assets or exit certain markets?	Sections 6.2.50 and 10.2	
Is impairment testing necessary for different classes of assets (e.g. inventory, investments, long-lived assets, goodwill)?	Section 6.2.50	
Leases	**Lessees**	**Lessors**
Has a lessee ceased use of a leased asset and can/will it sublease the asset (i.e. has an ROU asset been abandoned for accounting purposes)?	Section 6.3.10	N/A

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QUESTION	ADDITIONAL INFORMATION	
Have changes in market interest rates or other factors affected the lessee's incremental borrowing rate?	Section 6.3.10	N/A
Have either of the following occurred with respect to a renewal or purchase option? • The lessee exercised an option for which exercise was not previously reasonably certain. • The lessee did not exercise an option for which exercise was previously reasonably certain.	Section 6.3.10 (Lessee reassess-ments)	Section 6.3.20 (Purchase and renewal options)
Have any other lease reassessment events occurred, such as a change in the likelihood that a renewal, termination or purchase option will be exercised?	Section 6.3.10	N/A
Have any leases been modified/changed, temporarily abated (e.g. has a lease concession been granted) or terminated?	Section 6.3.10	Section 6.3.20
Is the lessee in bankruptcy?	Section 6.3.10	N/A
Have collectibility considerations related to lease payments changed (e.g. it is no longer probable that the lessor will be able to collect amounts owed from lessees)?	N/A	Section 6.3.20
Have the recoverability of ROU assets for lessees or the recoverability and estimated useful lives of leased assets for lessors been negatively affected?	Section 6.2.10	Section 6.3.20
Have temporary measures significantly curtailed a lessee's ability to use, and derive the intended economic benefits from using, an underlying leased asset?	Section 6.3.30	
Have fair values declined for the underlying asset and/or ROU asset for lessees or the leased asset for lessors?	Section 6.3.30	
Equity method investments		
Are there indications that an equity method investment is impaired?	Section 6.4	

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6.2 Long-lived assets

Long-lived assets, including lessee ROU assets recognized under Topic 842, may be affected by various forms of unforeseen or sudden economic disruption. These assets are critical to operations, and impairment may send a signal to financial statement users about the state of a company's current operations and potential future prospects. Therefore, in instances of sudden or sustained economic disruption, it is imperative for management to determine whether long-lived assets or asset groups may be impaired.

Economic disruption may prompt companies to reevaluate their supply chains. In some cases, companies may accelerate previously planned changes, such as diversifying sourcing or moving production closer to end markets, to reduce exposure to geopolitical or trade-related risks. These types of operational shifts can affect the accounting for long-lived assets. For example, leases may be terminated earlier than originally anticipated or may not be renewed as previously planned, assets (including ROU assets) may be abandoned or idled or depreciation/amortization estimates may need to be revised.

6.2.10 Long-lived asset impairment

When a company experiences economic disruption, an impairment triggering event – i.e. a suggestion that an asset group may not be recoverable – may occur.

If a company believes a triggering event has occurred, it first determines whether the asset group is recoverable (Step 1). If not, then fair value measurement of the asset group (Step 2) is required.

The asset group, which is the lowest level of identifiable cash flows that are largely independent from other asset groups, is the unit of account used to evaluate long-lived assets for impairment.

A 'triggering event' is an indication that an asset group may not be recoverable. Triggering events that may exist in periods of economic disruption include the following:

- a significant adverse change in one or more of the following:
  - market price;
  - extent or manner of use (including idling or abandonment);
  - physical condition;
  - legal or regulatory factors;
  - production levels in operating facilities; and/or
  - wasted material or spoilage;
- the acquisition or construction costs incurred or expected to be incurred for a long-lived asset significantly exceed the amount originally expected;
- a current-period operating or cash flow loss and a history of operating or cash flow losses or a projection/forecast of continuing losses due to loss of customers or increased costs to produce or provide goods and services;

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- a more-likely-than-not (i.e. greater than 50%) expectation of selling or otherwise disposing of a long-lived asset significantly before its previously estimated useful life ends; and
- entering into an unfavorable sublease of a leased asset (ROU asset).

In addition, a sustained decline in a company's share price may indicate an underlying operational issue potentially affecting the recoverability of long-lived assets. The potential existence of triggering events in this situation should not be ignored.

Step 1 recoverability test

In Step 1 of the two-step Topic 360 impairment model, a recoverability test is performed by estimating the undiscounted future cash flows from the use and eventual disposition of the asset (asset group) and comparing that estimate to the carrying amount of the asset (asset group).

The cash flows used for the Step 1 recoverability test need to be updated for known or expected events, such as the loss of a significant customer or tenant, a more general reduction in demand, an increase in costs or the incurrence of restructuring or severance costs due to closures during difficult economic conditions.

Additionally, changes in management's plans or the company's ability to hold an asset or asset group may alter the time period used for recoverability – i.e. the length of cash flows projected. In all cases, the projected undiscounted cash flows used for the recoverability test should be consistent with the information the company uses for both internal planning and external communication.

Topic 360 does not require a company to apply a single approach to testing all asset groups for recoverability. Some companies apply a best-estimate approach while others apply a probability-weighted approach. Depending on the facts and circumstances surrounding certain events, estimating probability-weighted cash flows for multiple outcomes may be appropriate due to uncertainty around the severity and duration of the economic impact from those events, even if the company used a best-estimate approach in prior periods.

In addition, negative trends are assessed to determine whether they apply to a specific point in time or an extended period of time. For example, declines in profit as a result of a pandemic or natural disaster may be short-lived or extend into the foreseeable future. When determining the impact on the recoverability of long-lived assets, companies not only assess the current period, but analyze the impact of the economic event(s) over the remaining useful life of the asset(s) (see section 6.2.30).

See chapter 7 of KPMG Handbook, Impairment of nonfinancial assets, for further discussion of the recoverability test.

Step 2 impairment test

Step 2 of the two-step Topic 360 impairment model is performed for each asset group where impairment indicators (i.e. triggers) have been identified and the company has failed the Step 1 recoverability test. In Step 2, the Topic 820 fair

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value of each of these asset groups is compared to its respective carrying amount with any deficit recorded as an impairment loss.

The impairment loss of the asset group is allocated to the long-lived assets comprising that group. However, the loss allocated must not reduce the carrying amounts of individual long-lived assets below their respective fair values. [360-10-35-28]

ROU asset considerations

As Topic 842 was implemented and initially applied, specific questions arose about applying the Topic 360 impairment model to ROU assets. More common questions are included in the following table (not exhaustive).

Question	Response
How do lease liabilities factor into the Step 1 recoverability test?	It depends on the classification of the lease as finance or operating. For operating leases, including or excluding the lease liabilities in the same asset group carrying amount may be acceptable. However, we would not expect the election in this regard to have a significant effect on the outcome of the Step 1 test. See Question 6.5.10 of KPMG Handbook, Leases, for additional detail.
Should operating lease liabilities be included in the asset group carrying amount when performing the Step 2 impairment test?	It depends. Operating lease liabilities should be included or excluded from the asset group carrying amount consistent with how they were treated for the Step 1 recoverability test. Consistent with Step 1, we would not expect this to have a significant effect on the outcome of Step 2. See Question 6.5.35 of KPMG Handbook, Leases, for additional detail.
Can an impaired ROU asset simply be written down to zero?	No. Long-lived assets, including ROU assets, cannot be impaired below their individual fair values. An ROU asset will typically not have a fair value of zero, and therefore should not usually be fully impaired. See Question 6.5.40 of KPMG Handbook, Leases, for additional detail.

KPMG Handbook, Impairment of nonfinancial assets, discusses long-lived asset impairment in additional detail, while section 6.5 of KPMG Handbook, Leases, discusses specific considerations around assessing impairment of lease ROU assets.

Revising asset groups

Changes in facts and circumstances caused by economic disruption may warrant reassessing asset groups if the lowest level of identifiable cash flows changes.

A lessee reassesses an ROU asset's Topic 360 asset grouping if and when there is a change in facts and circumstances (and not solely a plan to make a change). Examples of change actions that would typically trigger such a reassessment include changes in how the asset is used in operations, the

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lessee entering into a sublease of the underlying asset or the lessee ceasing use of the underlying asset.

See Question 6.5.60 of KPMG Handbook, Leases, for additional detail.

See section 3.3.50 of KPMG Handbook, Impairment of nonfinancial assets, for details and examples related to revising asset groups.

Fair value considerations

In periods of economic disruption and uncertainty, fair value measurements may pose unique challenges. Some example considerations include the following (not exhaustive).

Highest and best use	Changes in facts and circumstances may have altered the highest and best use of the asset group.
Discount rate	Changes in company and macroeconomic conditions can impact the discount rate and influence the outcome of a fair value analysis. See section 5.5.
Forecasted financial information	Projected financial information can be less predictable due to economic disruption. Anticipated downward changes to a forecast may influence the outcome of a fair value analysis. See section 5.5.
Market multiples	Market multiples may be volatile or unavailable for comparable asset groups.
Replacement costs	Replacement costs may have changed for certain factory plant and equipment due to inflation or supply chain disruptions.

See section 8.4 of KPMG Handbook, Impairment of nonfinancial assets, for a discussion of fair value measurement. For an in-depth discussion of how to measure fair value under Topic 820, see KPMG Handbook, Fair value measurement.

6.2.20 Insurance recoveries

Economic disruption can lead to multiple types of contingencies as a company tries to understand the actual impacts to its business and any associated mitigating measures. Loss contingencies (see section 7.4.10) and potential insurance recoveries are two types of these contingencies.

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

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

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

This probability approach is commonly referred to as the 'loss recovery model'. [450-30-05-2]

Given the uncertainty of economic disruption, 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 shortly 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 all contingencies have been resolved, which generally happens when the claim is 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]

6.2.30 Long-lived asset useful life

The useful life of a long-lived asset is the period over which an asset is expected to contribute directly or indirectly to future cash flows. The estimated useful life of long-lived assets may require adjustment if management's plans change for an asset due either to a shift in the nature of operations or the impact of economic disruption, such as a slow-down in anticipated demand. [842-20 Glossary, FASB Concepts Statement 6, par. 149]

6.2.40 Abandoned and idled assets

When faced with certain types of economic disruption, some companies may abandon, or adopt a plan to abandon, long-lived assets or certain operations.

However, 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 due to a slowdown in demand or restrictions in response to a pandemic, but intends to resume operations in the future, the facility has not been abandoned. However, temporarily idling a long-lived asset may trigger an impairment of that asset or the asset group to which it belongs.

Although temporarily idling a long-lived asset may trigger an impairment, while the asset is idle the company does not stop depreciating (amortizing) it or recognizing lease cost in the case of an ROU asset. However, 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 the asset 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]

In other situations, the company may constructively abandon an asset without a formal plan or commitment when no future service potential exists due to a sudden or unexpected event or circumstance. Examples may include abandoning a warehouse, production facility or piece of heavy equipment in an area where political unrest or conflict is occurring. If an asset has been

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constructively abandoned, the carrying amount is written off (i.e. immediately depreciated to zero).

See section 4.3 of KPMG Handbook, Discontinued operations and held-for-sale disposal groups, for further discussion of accounting for disposals other than by sale.

6.2.50 Sequence of impairment testing

The impact of economic disruption may require companies to perform multiple impairment tests over various asset classes. The ordering of when to perform the impairment test and recognize an impairment (if any) is critical and carefully evaluated. In instances where a group of assets is being sold or divested, the ordering of impairment testing and recognition may be different compared to that for assets or a group of assets being held and used.

Held-and-used assets

When a company is experiencing economic disruption, it may need to test goodwill and other assets (e.g. long-lived assets, equity method investments, inventory) for impairment at the same time. Therefore, it is important that these assets are tested for impairment in the following order.

Step 1	Step 2	Step 3	Step 4
Test assets not in the scope of Topics 350/360	Test indefinite-lived intangible assets	Test long-lived assets	Test goodwill

See chapter 4 of KPMG Handbook, Impairment of nonfinancial assets, and KPMG Handbook, Discontinued operations and held-for-sale disposal groups, for further discussion of the sequence of impairment testing.

Held-for-sale assets (disposal groups)

If a company determines that it has met the held-for-sale (HFS) criteria, the order of impairment testing and measurement of the HFS disposal group is different and requires a two-step process.

Step A	Adjust the carrying amount of the assets in the disposal group not in the scope of Subtopic 360-10 by applying other relevant guidance. Examples of assets not in the scope of Subtopic 360-10 are goodwill, inventory and financial assets.
Step B	Reduce the carrying amount of the disposal group as a whole to fair value less cost to sell, if lower (i.e. the writedown loss). Costs to sell are the incremental direct costs incurred to execute the sale – e.g. broker commissions, legal and title transfer fees, closing costs before legal title is transferred.

See section 4.5 of KPMG Handbook, Discontinued operations and held-for-sale disposal groups, and section 10.2.10 for further discussion of when a disposal group meets the HFS criteria.

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6.3 Leases

Actions taken by the parties to a lease in response to economic disruption can impact lease accounting in multiple ways. For example, a lessee may be required to reassess and/or remeasure one or more of its leases or an ROU asset may be impaired (see section 6.2.10) or abandoned. In addition, a lessor may grant rent concessions or abatements or may conclude that it is no longer probable that it will collect amounts owed on certain leases. [842-30-25-3, 25-4, 35-1, 35-4, 55-28]

6.3.10 Lessee considerations

Abandonment

A lessee may conclude it can no longer make use of a leased asset because of economic disruption. In that case, the ROU asset is abandoned for accounting purposes when the lessee ceases use of the leased asset and either cannot or will not sublease the leased asset.

A lessee may have committed to a plan to sublease a leased asset prior to economic disruption occurring. As a result of the disruption, subleasing may no longer be practical, triggering abandonment accounting.

Importantly, the *temporary* idling of a leased asset is not an abandonment of the ROU asset (see section 6.2.40).

Section 6.5.2 of KPMG Handbook, Leases, discusses lessee abandonment of ROU assets in additional detail.

Lessee discount rates

A lessee typically uses its incremental borrowing rate (IBR) as the 'discount rate for the lease'. The IBR may be affected if interest rates significantly change or the lessee's borrowing costs otherwise change (e.g. because the lessee's credit rating declines). It is inappropriate to attempt to 'normalize' an IBR with adjustments the lessee would not otherwise make but for the economic disruption.

Section 5.6.2 of KPMG Handbook, Leases, discusses a lessee's IBR in additional detail.

Lessee reassessments

The effects of economic disruption may trigger a requirement for a lessee to reassess and/or remeasure one or more of its leases. Examples include the following.

- One or more actions a lessee takes in response to the economic disruption may trigger a requirement to reassess the term of the lease or an option to purchase the underlying asset. Such actions may include the exercise of a renewal or purchase option for which exercise was not previously reasonably certain, and/or not exercising a renewal or purchase option for which exercise was previously reasonably certain.

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- Economic disruption may trigger a contingency in the lease contract affecting the lease payments or the lease term – such as a minimum payment clause or a termination right.
- The expected residual value of an underlying asset may be affected by the economic disruption, requiring reassessment of the amount it is probable that the lessee will owe under a residual value guarantee.

Lessees should carefully evaluate their lease contracts and the impact of certain economic disruptions on those leases.

Section 6.6 of KPMG Handbook, Leases, discusses lease reassessments.

Lease modifications

Economic disruption may lead to rent concessions (e.g. free, reduced or deferred rent) or other lease modifications (e.g. lease term or leased space reductions). A lease modification is any change to the terms and conditions of a lease that results in a change in its scope or consideration.

Lease modifications and their accounting effects can vary widely. Section 6.7 of KPMG Handbook, Leases, discusses lessee accounting for rent concessions and other lease modifications in detail.

Lease terminations

If a lease is modified to terminate it early, but not *immediately*, that modification is a lease term reduction (see *Lease modifications* discussion).

However, when a lease is terminated early without having first been modified, any remaining ROU asset and lease liability are removed, with profit or loss recognized for the difference.

Section 6.8 of KPMG Handbook, Leases, discusses lease terminations in detail.

Lease accounting in bankruptcy

Guidance on lessee accounting for leases upon entering, and while in, bankruptcy, is included in section 4.7 of KPMG Handbook, Accounting for bankruptcies.

6.3.20 Lessor considerations

Lessor revenue recognition – collectibility

Economic disruption may adversely affect some lessees such that the lessor cannot conclude that it is probable that lease payments, or remaining lease payments, owed by those lessees will be collected. Collectibility issues may exist if lessees request rent payment deferrals or short pay (i.e. pay less than) contractually owed amounts.

The following table explains the accounting when collectibility is not probable at commencement of a lease.

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Lease classification	Accounting when collectibility is not probable at commencement
Sales type lease	The lessor does not recognize any lease revenue, or derecognize the underlying asset, until collectibility becomes probable or one of two specified events occurs (see paragraph 7.5.30 of KPMG Handbook, Leases). The lessor recognizes lease payments received, including variable lease payments, as a deposit liability until one of those events occurs. [842-30-25-3]
Direct financing lease	A lease cannot be classified as a direct financing lease if collectibility is not probable. A lease that would otherwise be classified as a direct financing lease, but for which collectibility is not probable, is classified as an operating lease. [842-10-25-3]
Operating lease	The lessor recognizes lease revenue on a cash basis until collectibility becomes probable. [842-30-25-12]

If lease commencement precedes the economic disruption, collectibility may be probable at lease commencement but change with the economic disruption. Lessor considerations in this situation are outlined in the table that follows.

Lease classification	Accounting when collectibility is probable at commencement
Sales type and direct financing leases	Lease classification as a result of changes in collectibility is not reassessed after the commencement date, even for significant economic disruption. Subsequent changes in the credit risk of the lessee are accounted for under the impairment guidance that applies to the net investment in the lease (i.e. Subtopic 326-20).
Operating lease	Lease classification does not change as a result of changes in collectibility. However, collectibility is assessed on an ongoing basis as facts and circumstances change after the commencement date. Section 7.5.2 of KPMG Handbook, Leases, addresses effects on lease revenue and operating lease receivables if collectibility is reassessed as no longer probable.

Section 7.5 of KPMG Handbook, Leases, discusses the Topic 842 lessor collectibility requirements in additional detail.

Purchase and renewal options

During periods of economic disruption, a lessee may:

- exercise a renewal or purchase option for which exercise was not previously reasonably certain; and/or
- not exercise a renewal or purchase option for which exercise was previously reasonably certain.

Lessors account for the change to what the lessee was previously considered reasonably certain to do as a lease modification (see the next topic).

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Modifications and terminations

Economic disruption may trigger changes to a lease contract. For example, a lessor may grant rent concessions (e.g. forgive or defer contractual rent) to protect the business relationship with the lessee experiencing economic disruption. A lessor and lessee may also agree to other changes to a lease (e.g. shortening the lease term or extending the lease term in return for reduced rent in the near term). The accounting for rent concessions and other lease modifications is approached carefully because the new or changed terms and conditions are a key factor in determining the appropriate accounting for the modification, including whether the contractual changes are a separate contract (i.e. separate from the original lease contract).

Section 7.6 of KPMG Handbook, Leases, discusses lessor accounting for lease modifications in detail.

Assets held for lease

This section applies only to assets of a lessor classified as property, plant and equipment. See chapter 4 for lessor assets classified as inventory.

Lessors may find that some of their underlying property, plant and equipment assets held for lease are impaired if lessee demand for those assets significantly decreases or rental rates decline precipitously.

Similarly, economic disruption may affect the useful lives and/or depreciation of those assets. For example, a lessor may decide to abandon some assets if lease demand decreases significantly, or the lessor's depreciation of a leased asset may change if, as a result of economic disruption, the salvage value of that asset declines.

See section 6.2 for broader long-lived asset considerations.

6.3.30 Considerations applicable to both lessees and lessors

Lease cost and operating lease revenue recognition

Temporary measures, such as an evacuation or pandemic-related shutdown, may significantly curtail a lessee's ability to use, and derive its intended economic benefits from using, an underlying leased asset.

For example, a retail store location in a shopping mall may be closed to the public such that the retailer (lessee) cannot generate sales from the location.

Some lessees and lessors may question whether it is appropriate to suspend lease cost and operating lease revenue recognition while these temporary measures are in place. For lessees, this refers to both the single lease cost arising from operating leases and ROU asset amortization in finance leases.

We believe it would be inappropriate to suspend lease cost recognition or operating lease revenue recognition as long as the lessee retains the right to use the underlying asset, even in a significantly curtailed manner. Consider the retail store location example above. Although the retailer cannot sell from the location, if the retailer has not vacated the space (e.g. its inventory is still stored

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there, its tenant improvements remain in place), the retailer still retains control over the use of the space and is still obtaining economic benefits, albeit limited, from its use.

Fair values

Multiple aspects of Topic 842 depend on fair value measurements. For example, the fair value of the underlying asset affects lease classification for both lessees and lessors and the accounting for sale-leaseback transactions. In addition, the fair value of an ROU asset affects whether and how much impairment is recognized on that asset. Fair values may be affected by significant economic disruption. [360-10-35-28, 842-10-25-2, 55-3, 842-40-30-1]

KPMG Handbook, Fair value measurement, discusses fair value measurement in additional detail.

6.4 Equity method investments

In times of economic disruption, companies may need to consider whether equity method investments have been affected by the economic disruption, and if so, whether to recognize an impairment.

An equity method investment may be impaired if its fair value under Topic 820 is less than its carrying amount.

When an investor concludes that its equity method investment is impaired at the reporting date, it must determine whether the impairment is temporary or other-than-temporary. The existence of an impairment indicator that led the investor to conclude its investment is impaired does not, by itself, establish that the impairment is other-than-temporary. The investor considers all relevant facts and circumstances, and no individual factor is necessarily determinative. If an investor concludes that an impairment is other-than-temporary, it reduces the carrying amount of the investment to its fair value by recognizing an impairment loss in its income statement.

When an investee has significant operations or exposure in impacted areas, the investor carefully considers the specific facts and circumstances and provides transparent disclosure about how it has evaluated the recovery of those investments.

Section 5.5 of KPMG Handbook, Equity method of accounting, discusses impairment of equity method investments.

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7. Liabilities

Detailed contents

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7.1 Questions to ask

Economic disruption may create a variety of uncertainties that can potentially lead to additional expenses and liabilities. Among other operational and financial challenges, companies may be subject to various contingencies and obligations that arise due to related events. Also, they may face issues maintaining compliance with debt covenants in a recessionary economy and have to seek relief from lenders by modifying debt agreements.

The following are example questions to consider that are specific to economic disruption and the potential impacts to debt classification, debt modifications, contingencies and associated accounts (not exhaustive).

QUESTION	ADDITIONAL INFORMATION
Debt classification	
Is the ability to service debt in the coming year impaired?	Section 7.2.10 Section 10.4
Is there debt in default at the balance sheet date, is there an expectation of defaulting on debt within a year after the balance sheet date and/or do any debt agreements include cross-default provisions?	Section 7.2.20
Is the company in compliance with its debt covenants?	Section 7.2.30
Is there the intent and ability to refinance an obligation in the future or is there a plan to draw down on an existing credit line?	Section 7.2.40
Are there any subjective acceleration clauses (e.g. a material adverse change clause) included in debt agreements?	Section 7.2.50
Debt modifications	
Has debt been modified (e.g. the lender granted a payment holiday) or exchanged?	Section 7.3.10
Has the company provided the necessary disclosures for any troubled debt restructurings?	Section 7.3.20
Contingencies	
Have any loss contingencies occurred, such as those related to pending or threatened litigation, natural disasters or other destructive events?	Section 7.4.10
Has there been any environmental contamination?	Section 7.4.20

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QUESTION	ADDITIONAL INFORMATION
Have any financial guarantees been provided?	Section 7.4.30
Is there uncertainty about whether obligations (e.g. tariffs) have been incurred?	Section 7.4.40

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7.2 Debt classification

7.2.10 Overall

A company whose operations are facing economic disruption may experience cash flow constraints. If the company has debt, its ability to service the debt and/or maintain compliance with its debt covenants may be affected. Such challenges can impact debt classification.

A debtor that presents a classified balance sheet classifies debt (or a portion thereof) as either a current or a noncurrent liability. [210-10-45-6 – 45-9]

- **Current liability.** A debt obligation is classified as current if (by its terms) the debt is due or will be due on demand within one year (or an operating cycle, if longer) from the reporting date.
- **Noncurrent liability.** A debt obligation due more than one year (or operating cycle, if longer) from the reporting date is classified as noncurrent.

The existence of debt defaults, covenant violations and/or subjective acceleration clauses may impact classification. These topics are discussed in more detail below.

For further discussion on all aspects of debt classification, see section 3.6 of KPMG Handbook, Debt and equity financing.

7.2.20 Debt default

A company experiencing financial distress due to economic disruption may be unable to service interest and principal payments as they become due. If a company has debt classified as noncurrent, it reassesses that classification when the company is in default at the balance sheet date.

Additionally, if the company is in compliance with debt covenants as of the balance sheet date, but expects to default on that debt within one year of its report release date due to an inability to meet required principal or interest payments, the company considers this as part of its overall going concern analysis (see section 10.4).

For further discussion on all aspects of debt classification, see section 3.6 of KPMG Handbook, Debt and equity financing.

Cross-default provisions

Companies with multiple debt agreements should be mindful of cross-default provisions when classifying debt. Such provisions typically dictate that if a company is in default on one of its debt agreements, another debt agreement containing a cross-default provision is automatically in default and also callable. The specific wording of these provisions determines their applicability and classification effects.

For further discussion on cross-default provisions, see Example 3.6.140 of KPMG Handbook, Debt and equity financing.

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7.2.30 Debt covenants

A company's inability to meet its covenants (both financial and nonfinancial) or other provisions of a debt agreement may affect the debt's balance sheet classification. During periods of economic disruption, a company may be more likely to incur a debt covenant violation.

In the event of a debt covenant violation, a company's debt may become callable by the lender at the balance sheet date. In such circumstances, the debt is classified as current unless either: [470-10-45-11]

- the lender waives its right to demand payment for more than one year from the balance sheet date; or
- it is probable that the borrower will cure the violation within a defined grace period (if applicable per the terms), thus preventing the obligation from becoming callable.

In either of the above scenarios, the company assesses its ability to maintain future covenant compliance, for both the covenant that was violated and any other covenants in the debt agreement. If a future covenant violation within a year of the balance sheet date is probable, the debt is classified as current, regardless of whether the lender provided a waiver, the violation was cured, or the debt agreement was modified by the lender to prevent a covenant violation at the balance sheet date.

Generally, if a covenant violation occurs (or is expected to occur) after the balance sheet date, but prior to the issuance of the financial statements, noncurrent classification of the related debt would still be appropriate as the violation occurred after the balance sheet date. Disclosures addressing the violation or a potential violation (as well as its adverse consequences in future periods) are required in the notes to the financial statements. SEC registrants must also consider providing related discussion in MD&A. [470-10-50-2]

There are certain **post**-balance sheet events pertaining to covenants at period-end that may impact debt classification **as of** the balance sheet date. For example, consider a debt agreement with a covenant that would make the debt callable by the lender if the audit report on the company's annual financial statements contains a going-concern modification. Because the audit report covers the period that includes the balance sheet date, the covenant violation causes the debt to be classified as current unless, for example, the lender waives its right to call the debt for any reason for a period of more than one year from the balance sheet date and/or certain other conditions are met.

For further discussion on all aspects of debt classification, see section 3.6 of KPMG Handbook, Debt and equity financing.

7.2.40 Financing activities considerations

A company's intent and ability to refinance an obligation in the future is considered when determining classification as of the reporting date. If its plans include drawing down on an existing credit line, it assesses whether the current environment would prevent that action. In doing so, the company considers:

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- any clauses in other existing debt agreements that may prevent it from drawing down additional funds to meet its working capital or operational needs; and
- negative covenants in its other debt agreements (e.g. restrictions preventing issuance of additional debt until existing debt has matured) or requirements to maintain a specific leverage ratio that could prohibit it from obtaining additional borrowings.

Further, issuers of variable rate demand notes, auction rate securities and similar instruments should review the totality of the arrangement to understand the potential impact of repricing delays, including any impact on the current interest rate and the ability to refinance any underlying agreements (e.g. letters of credit associated with the issuance).

For further discussion on all aspects of debt classification, see section 3.6 of KPMG Handbook, Debt and equity financing.

7.2.50 Subjective acceleration clauses

A subjective acceleration clause (SAC) in a debt agreement, such as a material adverse change clause, can affect the classification of the related debt. A SAC may allow a lender to demand immediate repayment of the debt if, for example, the borrower 'does not maintain satisfactory operating results' or experiences 'recurring losses' or 'financial difficulty'. [470-10 Glossary]

Whether such clauses impact balance sheet classification is based on the likelihood (remote, probable or somewhere in between) that the lender will accelerate the repayment of debt by invoking the SAC. Such clauses must be continually evaluated while the debt agreement is outstanding.

Economic uncertainty, recessionary conditions, depressed financial conditions and the like can affect a company's prior conclusions on the likelihood of a SAC being invoked. Rapidly evolving facts and circumstances in the wake of economic disruption can cause the results of these evaluations to change from previous reporting periods.

The likelihood of the lender invoking a SAC is based on the borrower's specific facts and circumstances and the terms of the SAC. The following table summarizes the accounting and disclosure considerations for each likelihood. [470-10-45-2, 470-10-50-4]

Likelihood of SAC being invoked	Accounting and disclosure considerations
Remote	A company is not required to reclassify the debt to a current liability nor to disclose the existence of the SAC. The likelihood of acceleration is remote when: • the lender previously has not accelerated due dates of loans that were made to the company that contained similar clauses; • the company is not aware of any reason why the lender would accelerate the due date; and

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Likelihood of SAC being invoked	Accounting and disclosure considerations
	• the financial condition and prospects of the company otherwise support the 'remote' assessment.
Reasonably possible	A company evaluates the facts and circumstances to determine the proper classification of the debt and appropriate disclosures. Recommended disclosures in this scenario include: • the nature and terms of the SAC; • the amount of the debt that would be due within one year of the balance sheet date; and • the date the debt would be due if the lender accelerates the due date.
Probable	A company treats the debt as a current obligation. It then evaluates its intent and ability to refinance the obligation on a long-term basis as described in Subtopic 470-10. If the company determines it cannot classify the debt as noncurrent, the company discloses: • the nature and terms of the SAC; • the amount of the debt that may be due within one year of the balance sheet date; and • the date the debt would be due if the lender accelerates its due date.

For further discussion of subjective acceleration clauses, see section 3.6.10 of KPMG Handbook, Debt and equity financing.

7.3 Debt modifications

Economic disruptions may impact a borrower's ability to repay debt. As a result, lenders may grant payment holidays or other types of relief. Some debt may be exchanged for new debt with more favorable terms.

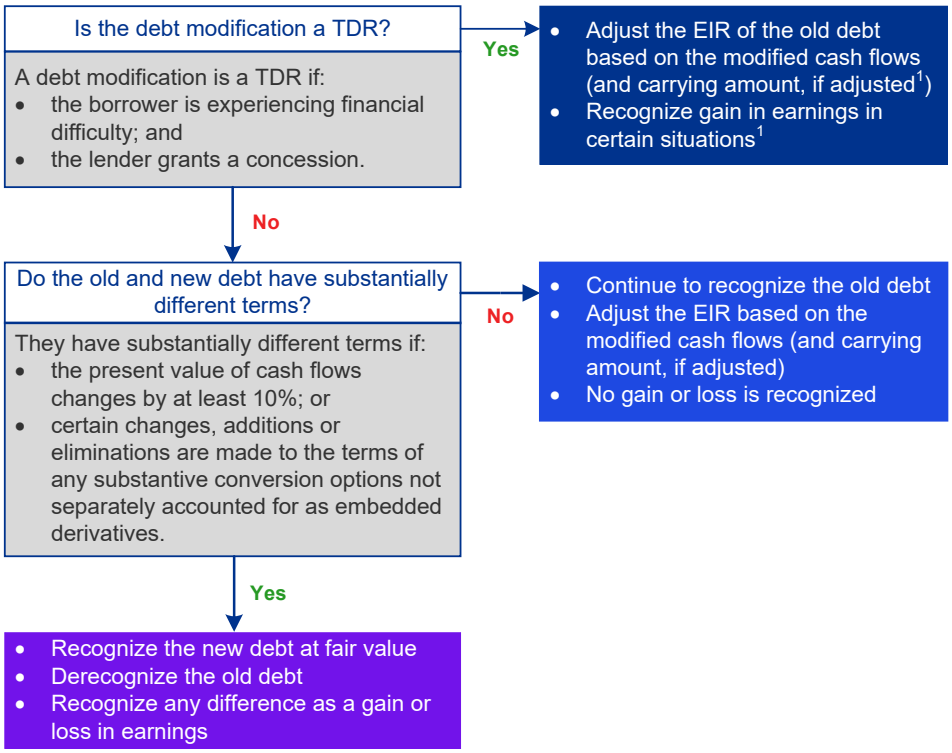
Depending on the facts and circumstances of the transaction, borrowers may need to consider the accounting for debt modifications, including whether a debt modification constitutes a troubled debt restructuring (TDR), debt modification or debt extinguishment (debt modification that results in the recognition of a new loan).

The considerations as to whether a debt modification constitutes a TDR can be complex with significant accounting and disclosure consequences. The necessary analysis can be further complicated in periods of economic disruption.

7.3.10 Determining how to account for a debt modification

A borrower's accounting for a debt modification under Topic 470 depends on whether it represents a TDR and whether the modified debt has substantially different terms, as summarized in the following decision tree.

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Note:

1. If the carrying amount of the old debt is greater than the undiscounted cash flows of the restructured debt, the carrying amount is adjusted to those undiscounted cash flows. This results in an EIR of zero and recognition of a gain.

Various considerations are involved in determining whether the borrower is experiencing financial difficulty or the lender has granted a concession.

Condition	Example considerations (not exhaustive)
Borrower is experiencing financial difficulty	The borrower may be experiencing financial difficulty if: • it is currently in payment default on any of its debt; • it has declared or is in the process of declaring bankruptcy; • there is significant doubt about whether it will continue to be a going concern; • it has securities that have been or are in the process (or under threat) of being delisted; or • it would be unable to obtain funds from sources other than existing lenders at an EIR equal to the current market interest rate for similar debt for a nontroubled borrower.
Lender has granted a concession	A lender has granted a concession if the borrower's effective borrowing rate on the restructured debt is less than the effective borrowing rate on the original debt immediately before the restructuring. However, such a decrease may not represent a concession in the rare circumstance that there is persuasive evidence that the rate decrease is due solely to a factor that is not captured in the mathematical calculation (e.g. additional collateral is provided).

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See chapter 4 of KPMG Handbook, Debt and equity financing, for further discussion of how to classify and account for debt modifications, extinguishments and TDRs.

7.3.20 Disclosures about TDRs

Topic 470 requires borrowers to disclose quantitative and qualitative information about TDRs. A summary of those disclosures is noted in the table below.

Topic 470 disclosure requirements
• A description of the principal changes in terms, the major features of settlement, or both • Aggregate gain on restructuring of payables • Aggregate net gain or loss on transfers of assets recognized during the period to settle a payable • Per-share amount of the aggregate gain on restructuring of payables • Quantitative and qualitative information regarding any contingently payable amounts

See chapter 4 of KPMG Handbook, Debt and equity financing, for further discussion of disclosure requirements related to borrower disclosures.

7.4 Liabilities and contingencies

Following certain events, such as a natural disaster or other destructive events resulting in economic disruption, accounting for loss contingencies and related insurance recoveries may become relevant. Accounting for financial guarantees may also become relevant if a company has to issue guarantees to other companies to continue to maintain operations.

Additionally, trade or tariff policies may give rise to incurred or contingent liabilities. Determining whether a liability exists under either Topic 405 or Subtopic 450-20 (loss contingencies) may involve judgment and require careful evaluation, including consultation with relevant specialists.

7.4.10 Loss contingencies

Loss contingencies are in the scope of Subtopic 450-20. They may result from pending or threatened litigation (e.g. based on the company's alleged actions during or in the aftermath of a natural disaster), potentially uninsured losses, etc.

A loss contingency is recorded and disclosed when: [450-20-25-2]

- information is available before the financial statements are issued (or available to be issued for non-SEC filers) indicating it is probable that an asset was impaired or loss incurred as of the date of the financial statements; and
- the loss can be reasonably estimated.

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Disclosure of a loss contingency is required if the recognition threshold was not met, but there is at least a reasonable possibility that a loss may have been incurred (or a loss in addition to that recognized). [450-20-50-3]

Periods of rapidly evolving facts and circumstances can complicate determining the date an asset was impaired or loss was incurred or identifying the information available to estimate the loss. In periods of economic disruption, companies should pay careful attention to the population of, accounting for, and disclosure of loss contingencies.

The recovery of a loss contingency is recognized using the same recognition threshold as the loss contingency itself. See section 6.2.20 for additional discussion about accounting for insurance recoveries. [610-30-25-4, 450-20-25-2, 410-30-35-8]

See chapters 3 to 6 of KPMG Handbook, Contingencies, commitments and guarantees, for further discussion on recognition, measurement, presentation and disclosure of loss contingencies.

7.4.20 Environmental obligations

Obligations related to environmental remediation are in the scope of Subtopic 410-30. Environmental contamination has a wide range of sources, such as:

- accidents at industrial and commercial facilities;
- oil and chemical spills; and
- accidents involving wastewater treatment plants and sewage systems.

Any of these events could potentially occur during a natural disaster, such as a hurricane or wildfire, or other types of destructive events, such as war. Government regulation governs the remediation of environmental contamination. When a company has been identified as a responsible party, it has an obligation to remediate the contamination. This obligation is recognized in the financial statements when it is reasonably estimable. [410-30-05-15]

7.4.30 Financial guarantees

Topic 460 requires the issuer of a financial guarantee (i.e. the guarantor) to record contingent losses associated with the guarantee as a liability at the inception of that guarantee. The accounting and measurement guidance differs for credit-related guarantees (Subtopic 326-20 (credit losses)) versus other financial guarantees (Subtopic 450-20 (loss contingencies)). [460-10-25-2 – 25-4]

Financial guarantees	
Credit-related guarantees	**Other financial guarantees**
The expected credit losses (the contingent aspect) are measured and accounted for under Subtopic 326-20 in addition to and separately from the fair value of the guarantee (the noncontingent aspect) in accordance with Subtopic 460-10. [460-10-25-2, 460-10-30-5]	The liability is measured as the greater of the amount that satisfies the fair value objective in Subtopic 460-10 and the contingent liability required to be recognized at inception in accordance with Subtopic 450-20. [460-10-30-2]

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For both types of guarantees, estimating the amount of the contingent loss typically requires a guarantor to make assumptions about both the likelihood of being required to perform under the guarantee and the amount of loss expected if such performance is required.

In periods of economic disruption, it can be particularly relevant for a guarantor to evaluate whether its estimate of contingent losses needs to be increased. For example, a guarantor might conclude that its estimate needs to increase because it is more likely to be required to perform and/or the amount of loss upon performance is expected to be greater than previously estimated.

See chapter 7 of KPMG Handbook, Contingencies, commitments and guarantees, for further discussion on guarantees.

7.4.40 Incurred vs contingent liabilities

Both incurred and contingent liabilities may be recognized on the balance sheet. The distinction between incurred liabilities and contingent liabilities is whether there is uncertainty about the fact that those obligations exist (i.e. have been incurred).

When there is no uncertainty that a liability has been incurred, it is recognized, even if the amount or timing of the liability is not currently known. For example, if it is clear that an entity has imported a good subject to tariffs, there is no uncertainty as to the existence of an obligation arising from the tariffs. In that case, a liability is recognized, even if the accrued amounts may have to be estimated.

However, evolving tariff policies, combined with the complexity of supply chains and import laws, may lead to a lack of clarity about whether a tariff obligation has been incurred. In such a case, we believe an entity should consider the legal basis for its position not to pay a tariff to evaluate whether an existence (or applicability) ‘uncertainty’ exists (and therefore whether Topic 450 applies).

For example, one approach to determining whether an existence uncertainty exists is to look at the guidance on evaluating income tax uncertainties – i.e. is it more likely than not that the entity’s position not to pay the tariff would be upheld by the customs authority.

- Conclude a liability has been incurred if it is more likely than not the entity has imported a product for which it will be required to pay a tariff.
- If it is more likely than not that its position to not pay the tariff will be upheld, treat the uncertainty as a contingency and assess whether to accrue the loss under Subtopic 450-20.

When assessing the likelihood of the position being upheld, an entity evaluates the legal basis assuming the customs authority has access to all relevant information – i.e. the entity does not consider detection risk.

In situations where the applicability of tariffs is unclear or evolving, companies should evaluate the legal and regulatory context based on their specific facts and circumstances, and consider involving legal, tax or accounting advisors where appropriate.

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See Question 2.2.30 of KPMG Handbook, Contingencies, commitments and guarantees, for further discussion of contingent versus incurred liabilities.

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8. Compensation and benefits

Detailed contents

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8.1 Questions to ask

In response to economic disruption, companies may take actions related to compensation and benefits that have an impact on financial reporting. Examples include:

- providing revised or new compensation arrangements;
- evaluating existing compensation arrangements to determine if any specific terms, conditions or estimates have been affected;
- making modifications to compensation and benefit arrangements; and
- taking workforce actions that could result in pension or postretirement curtailments or settlements, or the need to pay severance and other postemployment or postretirement benefits.

The following are example questions to consider that are specific to economic disruption and the potential impact to compensation and benefits and associated accounts (not exhaustive).

QUESTION	ADDITIONAL INFORMATION
Have either of the following related to share-based payments been affected: • the probability assessment for performance-based awards; and/or • the volatility input used to value awards on the grant date?	Section 8.2.10
Have any share-based payment awards been modified (e.g. changes to vesting criteria or exercise price) and/or are discretionary clauses or clawback provisions starting to be included in awards?	Section 8.2.20
Have termination benefits (voluntary or involuntary) been offered or implemented?	Section 8.3.10
Has a significant event occurred (e.g. plan amendment, curtailment or termination) that could cause an interim remeasurement of defined benefit pension or postretirement plan assets and obligations?	Section 8.3.20
Have new or revised sick leave or paid time off policies been implemented or have furlough arrangements been offered to employees?	Section 8.3.30

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8.2 Share-based payments

8.2.10 Performance and market conditions

Performance conditions #

A performance condition is a condition affecting the vesting, exercisability, exercise price or other pertinent factors used in determining the fair value of an award that relates to both: [718-10 Glossary]

- rendering service or delivering goods for an explicit or implicit period of time; and
- achieving a specified performance target that is defined solely by reference to the grantor's own operations (or activities) or by reference to the grantee's performance related to the grantor's own operations (or activities).

For awards with performance conditions, compensation cost is recognized when it is probable that the performance condition will be achieved. When faced with economic disruption, a company revisits its probability assessment of performance-based awards to determine if achievement of a performance condition has changed. [718-10-25-20]

For further discussion, see paragraph 4.102 of KPMG Handbook, Share-based payment.

Market conditions #

A market condition is a condition affecting the exercise price, exercisability or other pertinent factors used in determining the fair value of an award that relates to the achievement of either of the following: [718-10 Glossary]

- a specified price of the issuer's shares or a specified amount of intrinsic value indexed solely to the issuer's shares; or
- a specified price of the issuer's shares in terms of similar equity shares.

The requisite service period of an award with a market condition may be explicitly stated or it may need to be derived from the valuation technique used to estimate the grant-date fair value of the award. While changes in the market due to economic disruption may result in the market condition not being achieved, the effect of the market condition is reflected in the award's fair value measurement. For equity-classified awards, this uncertainty is incorporated into the grant-date fair value of the award. As a result, compensation cost for an equity-classified award is recognized if the service conditions are met by the grantee, regardless of whether the market condition is ultimately achieved. Liability-classified awards are remeasured at fair value each reporting period until settlement. [718-10-30-14]

While the accounting for previously granted awards is generally not affected by market volatility introduced by economic disruption, companies need to consider whether the volatility input used in the grant-date fair value calculations for new awards remains appropriate or requires adjustment.

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For further discussion, see paragraph 4.108 of KPMG Handbook, Share-based payment.

8.2.20 Modifications

In response to economic disruption, existing share-based payment awards with service, performance and/or market conditions may be reevaluated. Upon making a change to the terms or conditions of an existing award, a company must assess if that change results in a modification of the award. Changes made to a service, performance or market condition generally require modification accounting. Modification accounting is applied when either the fair value, vesting conditions or the classification of the award are not the same immediately before and after the modification. [718-20-35-2A – 35-9]

The following table includes different types of modifications, example modification scenarios (not exhaustive) for each type that may arise in periods of economic disruption and the related accounting implications.

Examples	Accounting implications
Changing performance conditions	
Performance conditions may be modified due to changes in the probability of the performance condition being met (e.g. revising revenue targets).	A change in a performance condition results in modification accounting.
Changing market conditions	
Market conditions may be modified to change the exercisability of the award (e.g. an award exercisable if the shares outperform the S&P 500 by a given percent may be modified to change the required percent or index by which exercisability is measured).	For equity-classified awards, when a market condition is modified, the probability of satisfying the original market condition does not affect the recognition of compensation cost because the market condition was incorporated into the original grant-date fair value. As a result, when determining the compensation cost of the revised award, compensation cost is not reduced below the original award's grant-date fair value if the service conditions are expected to be satisfied at the modification date. Liability-classified awards are remeasured at fair value each reporting period until settlement.
Repricing of awards	
Options may be repriced to reduce the exercise price when a decrease in the company's share price causes the options to become out of the money.	When a share-based payment award is repriced, the effects of the modification are measured by comparing the fair value of the award immediately before and after the repricing.
Accelerating vesting of awards	
Awards with vesting conditions may be modified to accelerate vesting ahead of	When the vesting of a share-based payment award is accelerated, the

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Examples	Accounting implications
achieving the stated vesting criteria (i.e. requisite service period).	accounting consequences depend on whether the terms and conditions of the award included an acceleration clause for the circumstance that triggered the acceleration. If the terms and conditions do not include such an acceleration clause, modification accounting is applied at the time of the acceleration.
Adding or changing discretionary clause or clawback provision	
Discretionary clauses provide latitude to compensation committees – e.g. they allow the committees to clawback a previously vested award or to subjectively determine whether a performance condition has been achieved. Awards may be modified to add discretionary clawback provisions or to expand the committee's discretion.	If the discretionary clause provides compensation committees with significant subjectivity, there may be no shared understanding of the terms and conditions of the award. In that case, a grant date has not been established, which affects both the measurement of the award and the attribution period. If the discretionary clause does not delay the grant date, then it is necessary to consider whether invocation of the clause results in modification accounting.

For further discussion, see chapter 5 of KPMG Handbook, Share-based payment.

8.3 Employee benefits

8.3.10 Termination benefits

Voluntary termination benefits

In periods of economic disruption, companies may need to reduce the size of their workforce. Offering voluntary (also known as special) termination benefits may be an avenue to achieve this goal.

Voluntary termination benefits are typically offered by employers for a short period in exchange for an employee's voluntary termination of employment, including early retirement. Companies recognize voluntary termination benefits as a liability and an expense when the employee irrevocably accepts the offer, and the amount can be reasonably estimated. Voluntary termination benefits offered through a postretirement benefit plan could be a significant event and result in an interim remeasurement of postretirement benefit plan assets and obligations (see section 8.3.20). [712-10-25-1, 715-30-25-10]

In certain circumstances, voluntary termination benefits are related to company restructuring events or activities that also result in pension or postretirement plan settlements, curtailments or amendments.

For further discussion, see section 4.3 of KPMG Handbook, Employee benefits.

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Involuntary termination benefits #

Involuntary termination benefits are provided by an employer to employees in connection with their termination of employment. The appropriate accounting for involuntary termination benefits depends on whether the costs will be paid under a contractual arrangement, an ongoing plan or a one-time benefit arrangement. The table below helps determine which Topic applies, depending on the type of involuntary benefit offered. [712-10-15-4]

In addition, some involuntary termination benefits are related to company restructuring events or activities that also result in pension or postretirement plan settlements, curtailments or plan amendments (see section 8.3.20).

Nature	Accounting
Topic 712 (nonretirement postemployment benefits) Involuntary termination benefits under Topic 712 fall into one of two categories with the accounting being dependent on the nature of the plan.	
Contractual termination benefits Benefits that are provided to employees who are involuntarily terminated upon the occurrence of a triggering event specified in the terms of a plan (e.g. a plant closing). [712-10 Glossary]	
Contractual termination benefits are benefits required by the terms of a plan or agreement only upon the occurrence of a specified event. A common example is a union contract that includes provisions to pay severance in the event of a plant or office closure. Because these benefits are contractual, it is important for companies to assess the impact of actions taken in the wake of economic disruption to determine if any events may trigger accounting for contractual termination benefits.	Contractual termination benefits are recognized as a liability and an expense when it is probable that employees will be entitled to such benefits and the amount can be reasonably estimated. [712-10-25-2] For further discussion, see section 4.5 of KPMG Handbook, Employee benefits.
Other postemployment benefits Benefits, other than special or contractual termination benefits, that are provided after employment but before retirement. [712-10 Glossary]	
Other involuntary termination benefits, i.e. those that do not meet the definition of contractual termination benefits, could be provided through an ongoing plan, which may be written or achieved through consistent past practices. However, the benefits are not dependent on the occurrence of a specified event under the plan. These benefits are paid under an ongoing arrangement or substantive plan to former employees, inactive employees or beneficiaries and covered dependents of former or inactive employees.	If other involuntary termination benefits vest or accumulate, they are recognized as the employees provide service. Benefits that do not vest or accumulate are accounted for using a loss contingency model and are recognized as a liability when the payment of benefits is both probable and reasonably estimable. [712-10-25-4 – 25-5] For further discussion, see section 4.6 of KPMG Handbook, Employee benefits.

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Nature	Accounting
Topic 420 (exit/disposal cost obligations)	
One-time termination benefits Benefits provided to current employees who are involuntarily terminated under the terms of a one-time termination benefit arrangement. [420-10 Glossary]	
One-time termination benefits could be provided on their own or in addition to base contractual termination benefits or base termination benefits provided through an ongoing plan. These benefits must be paid to current employees who are involuntarily terminated and cannot be paid under an ongoing benefit arrangement or deferred compensation contract. Examples of these include one-time severance payments made to employees specifically terminated by the reduction in force and not part of an ongoing termination plan.	One-time termination benefits are recognized at fair value on the communication date. However, if the employee is required to render services beyond a minimum retention period (which cannot exceed the legal notification period or, in its absence, 60 days), the liability is measured at fair value on the communication date and recognized ratably over the future service period. [420-10-25-6 – 25-9] For further discussion, see section 4.7 of KPMG Handbook, Employee benefits.

8.3.20 Defined benefit plans

Interim remeasurement #

During periods of economic disruption, market prices and interest rates may be significantly different from when a company performed its most recent measurement of defined benefit plan assets and obligations. These differences may result from direct market effects of economic disruption, such as increases in the risk-free rate or significant equity market volatility, or from indirect effects of economic disruption, such as workforce reductions, restructurings or plan termination events that may require remeasurement of plan assets and obligations.

A company is only required to measure plan assets and benefit obligations as of the date of its fiscal year-end except in certain situations, such as the following.

- The company has a policy to remeasure those amounts every period (e.g. quarterly).
- A significant event occurs that was caused by the entity, such as a plan amendment, curtailment or settlement.
- The company has a policy to remeasure those amounts in response to infrequently occurring events other than plan amendments, curtailments or settlements.

An interim remeasurement is not required as a result of changes in market prices or interest rates *that may be significant but are not caused by the entity*.

When a significant event occurs (i.e. a settlement, gain due to curtailment, plan amendment and special termination benefits), plan assets and the benefit

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obligation are remeasured as of the date the event occurs. When there is a loss expected due to curtailment, it is measured when probable and estimable. When the interim remeasurement date does not coincide with a month-end, the company may remeasure plan assets and benefit obligations using the nearest month-end. Because changes in market prices or interest rates are not changes that are caused by the company, it does not adjust for differences in market prices or interest rates that may have occurred between the significant event date and the month-end measurement date. As a result, and due to the volatility in the environment associated with economic disruption, determining the appropriate measurement date may be more difficult, and defaulting to the closest month-end or quarter-end date could change the valuation significantly. [715-30-35-66 – 35-66B, 715-60-35-126A – 35-126B]

In addition, companies need to consider whether to account for an interim settlement when the cumulative cost of all settlements (e.g. due to lump-sum payments or other actions) during the year is *expected* to exceed the sum of the service cost and interest cost components of net periodic pension or postretirement cost for the year. [715-30-35-82, 715-60-35-149]

For further discussion, see section 8.7 of KPMG Handbook, Employee benefits.

Discount rate

A company's hypothetical bond portfolio used to measure the discount rate may comprise high-quality bonds across multiple sectors. In times of economic disruption, interest rates for high-quality bonds in a particular sector may see yield increases (or decreases) that differ from the market at large. This can cause a change in the discount rate that differs from general interest rate trends. Companies might adjust their hypothetical bond portfolio to avoid mismatches between derived discount rates and general trends by selecting bonds that align better with overall interest rate trends.

To better align with these trends, companies might exclude predefined sectors. Companies should avoid averaging bond yields and weighting outlier bonds differently, as this may compromise the measurement objective of selecting a discount rate at a point-in-time that best reflects the rate (1) at which the benefit obligation could be settled currently and (2) that considers the general trend in interest rates since the last measurement date. [715-30-35-45, 715-60-35-80]

A change in the approach to selecting the discount rate due to economic disruption should be treated as a change in estimate, not as a change in accounting principle. Retrospective application is not required. [715-30-55-26 – 715-60-55-27]

For further discussion, see section 8.3, and in particular, Question 8.3.80 of KPMG Handbook, Employee benefits.

Expected long-term rate of return on plan assets

Companies usually review annually whether to adjust their long-term rate-of-return assumption. In many cases, this assumption remains unchanged if long-term projections are consistent with previous estimates. Market value changes from economic disruption alone do not necessitate a change in this assumption, but factors like investment return estimates, asset mix changes, and shifts in

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investment strategy may prompt a reassessment. We suggest companies document their rationale for the selected long-term rate-of-return assumption.

Further, during times of economic disruption, a company's policy for determining the market-related value of plan assets (used to calculate the expected long-term return on plan assets) may have a financial statement effect. Some companies use the fair value of plan assets, while others use a calculated value that delays recognizing changes in fair value (smoothing). A significant decline in an investment portfolio's fair value, as may be experienced during periods of economic disruption, would affect financial statements by decreasing the return-on-asset component of benefit cost and net income for those using the fair-value method. Companies employing smoothing techniques may experience less of an effect in such periods because the base value would generally be higher than the available investment portfolio that generates the returns. These companies will likely generate experience losses, recorded in accumulated other comprehensive income and subject to future amortization if cumulative equity amounts fall outside the corridor. [715-30 Glossary, 715-60 Glossary]

Companies may change their policy for determining the market-related value of plan assets if they demonstrate the new policy is preferable and retrospectively apply it to all previous periods. It is generally not preferable to smooth market-related value determinations if the prior policy used fair value.

For further discussion, see Questions 7.3.60 and 7.5.10 of KPMG Handbook, Employee benefits.

Rollforward techniques

To meet accelerated filing requirements, companies often select discount rates and obtain fair value data from trustees before the balance-sheet date, supplementing this with a market analysis. In periods of economic disruption, the analysis may need to be more thorough, focusing on the plan's specific investments and bonds used to select the discount rate.

For further discussion, see Question 8.7.10 of KPMG Handbook, Employee benefits.

8.3.30 Paid time off and furlough arrangements

Sick pay and paid time off

During or following certain types of economic disruption, such as a natural disaster or a pandemic/endemic disease, a company may consider extending or revising its sick leave or paid time off policies. A liability is accrued for sick leave or paid time off when certain conditions are met, including when the policy provides for sick leave or paid time off rights that vest or accumulate. When there is no vesting or accumulation of these benefits, compensation for an employee's absence due to sick leave does not meet the liability accrual requirements. Whether a liability accrual is needed depends on the terms and conditions of the paid time off policies. [710-10-25-1, 25-6 – 25-7]

Recent employment practice commonly combines sick pay with other types of paid time off, such as vacation, which may necessitate accrual. It is important to

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review the vacation or overall paid time off policy to determine the appropriate accounting treatment.

For further discussion, see section 3.2 of KPMG Handbook, Employee benefits.

Furlough arrangements

During certain types of economic disruption, companies may consider offering furlough arrangements to their employees to save costs but retain their workforce until those employees can return to work. For example, retail stores may temporarily close and furlough all their employees, or restaurants may offer only limited take-out services and furlough only some employees.

Furlough arrangements are different from compensated absences or extended sick pay policies because furlough arrangements typically consist of employees taking mandatory time off with no or reduced pay and/or a continuation of fringe benefits. Furlough arrangements may or may not be for a specified period of time. There are different ways in which a company may structure a furlough arrangement, and judgment may be required to determine the appropriate timing of expense recognition.

Depending on the facts and circumstances, furlough arrangements are usually accounted for under Topic 710 on compensated absences or Topic 712 on postemployment benefits. Under either model, an accrual is recognized when:

- the furlough arrangement provides benefits that vest or accumulate; and
- the furlough costs are probable and reasonably estimable.

When furlough benefits do not vest or accumulate, which is often the case, determining when furlough-related costs are accrued is less clear.

In particular, furlough benefits accounted for under Topic 712 that do not vest or accumulate are accrued when the event creating the obligation occurs and the costs become probable and reasonably estimable. In contrast, furlough benefits accounted for under Topic 710 that do not vest or accumulate are not accrued when the furlough begins. Instead, furlough-related costs are accounted for as period costs.

Determining which Topic furlough benefits fall under requires a company to analyze the terms of the furlough arrangement.

For further discussion, see Question 4.6.80 of KPMG Handbook, Employee benefits.

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9. Income taxes

Detailed contents

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9.1 Questions to ask

In response to economic disruption, companies may take certain actions or may otherwise be impacted in ways that can affect accounting for income taxes or may impact the company's ability to realize deferred tax assets.

The following are example questions to consider that are specific to economic disruption and the potential impact to income taxes and associated accounts (not exhaustive).

QUESTION	ADDITIONAL INFORMATION
Is the company unable to reliably estimate the annual effective tax rate?	Section 9.2.10
For a multinational company, has the disruption impacted one of the jurisdictions such that a separate effective tax rate is required for that specific jurisdiction?	Section 9.2.20
Have any significant unusual or infrequently occurring transactions taken place?	Section 9.2.30
Are updates needed to the apportionment factor (i.e. the percentage of a company's profits subject to various tax jurisdictions)?	Section 9.2.40
Are there unexpected interim period ordinary losses that exceed those expected for the full fiscal year?	Section 9.2.50
Has the probability of realizing deferred tax assets declined below the 'more-likely-than-not' threshold due to a change in the ability to generate sufficient taxable income of the appropriate character?	Section 9.3
Is the company considering repatriation of earnings from a foreign jurisdiction where the indefinite reversal exception has been used to justify not recognizing a deferred tax liability for a taxable outside basis difference of an investment in a subsidiary within that jurisdiction?	Section 9.4

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9.2 Estimating the annual effective tax rate

9.2.10 Inability to make reliable estimates

A company recognizes income tax expense in interim periods based on its estimated annual effective tax rate. In periods of economic disruption, a company may experience an overall contraction in its business and face new challenges estimating its annual effective tax rate, despite making reliable estimates in the past.

When significant volatility in operations affects management's ability to reliably estimate the company's annual effective tax rate, the actual year-to-date effective tax rate may be used as the best estimate of the annual effective tax rate. This may be an appropriate approach when the estimated annual effective tax rate is sensitive to small changes in ordinary income (e.g. because the company expects near break-even operations). [740-270-25-2 – 25-4, 30-2 – 30-8, 30-18, 35-2]

9.2.20 Multinational companies

Multinational companies generally calculate one overall estimated annual effective tax rate. However, separate calculation of the effective tax rate in an individual jurisdiction and exclusion of that jurisdiction from the overall annual rate is needed if: [740-270-30-36]

- the jurisdiction has experienced year-to-date losses (or expects losses for the year) for which no tax benefits can be recognized; or
- the company is unable to reliably estimate the effective tax rate for the jurisdiction.

Section 10 of KPMG Handbook, Accounting for income taxes, discusses estimating the annual effective tax rate.

9.2.30 Significant unusual or infrequently occurring items

Ordinary income excludes significant unusual or infrequently occurring items. Unusual or infrequently occurring items are those events or transactions that are unusual in nature or occur infrequently, or both. If unusual or infrequently occurring items are material, they are reported as a separate component of income from continuing operations or, alternatively, disclosed in the notes to the financial statements. The tax effects of separately reported significant unusual or infrequently occurring items are excluded from the estimated annual effective tax rate and instead recognized in the interim period in which the item arises. [740-270 Glossary, 220-20-50-3, 740-270-30-12 – 30-13]

In periods of economic disruption, if a company experiences significant unusual or infrequently occurring items it must consider whether their tax effects are properly recognized and disclosed.

Depending on the facts and circumstances, examples of items that may potentially qualify as significant unusual or infrequently occurring items include:

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- indefinite-lived intangible asset or goodwill impairments;
- long-lived asset impairments;
- loan modifications;
- lease modifications; and
- debt restructurings.

Section 10 of KPMG Handbook, Accounting for income taxes, discusses the tax effects of items excluded from ordinary income.

9.2.40 Apportionment

During periods of economic disruption, companies may experience changing levels of operations and profitability in different tax jurisdictions – e.g. domestic versus foreign, one state versus another state. These changes may require updates to the apportionment factor, or the percentage of a company's profits subject to various tax jurisdictions, when developing the estimated annual effective tax rate. These changes may also need to be considered as part of the rate used to record deferred taxes at year end.

Section 3 of KPMG Handbook, Accounting for income taxes, discusses the income tax calculation, including the effects of apportionment, in additional detail.

9.2.50 Interim period losses

A company experiencing unexpected ordinary losses as a result of, or tangential to, economic disruption may need to do the following, based on the facts and circumstances, if the unexpected ordinary losses exceed those expected for the full fiscal year:

- adjust its estimated annual effective tax rate; and/or
- limit its year-to-date tax benefits.

A company recognizes the tax effects of losses that arise in interim periods only if the benefits are more likely than not to be realized during the year (e.g. through ordinary income expected in later interim periods) or in a future year (e.g. through recognition of a deferred tax asset with no valuation allowance). As a result, if a company expects a loss for the full fiscal year, it must include in its estimated annual effective tax rate the amount of the valuation allowance it expects it will need at the end of the year. [740-270-25-9, 30-7, 30-30 – 30-31]

Section 10 of KPMG Handbook, Accounting for income taxes, discusses the tax effects of losses in interim periods in additional detail.

9.3 Valuation allowance

Deferred tax assets are recognized for most deductible temporary differences and operating loss and tax credit carryforwards. A valuation allowance is required for deferred tax assets if, based on available evidence, it is more likely than not that all or some portion of the asset will not be realized due to the

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inability to generate sufficient taxable income in the period and/or of the character necessary to use the benefit of the deferred tax asset.

Companies that have historically not recorded a valuation allowance on their deferred tax assets due to the assertion that they were more likely than not to realize these assets in a future period may experience unexpected ordinary losses or capital losses during periods of economic disruption. These companies may need to analyze whether those conditions result in the inability to realize deferred tax assets. [740-10-30-16 – 30-25]

Section 4 of KPMG Handbook, Accounting for income taxes, discusses valuation allowances in additional detail.

9.4 Repatriation of foreign earnings

Within a multinational company, a parent company may have an outside basis difference in its investment in a foreign subsidiary (or a foreign corporate joint venture) resulting from undistributed earnings of the subsidiary, which may result in a future taxable amount or a deferred tax liability. Under certain circumstances, the parent company may utilize the indefinite reversal criterion to not recognize a deferred tax liability for the basis difference. [740-30-25-17]

During periods of economic disruption, companies with foreign subsidiaries must continue to assess the facts and circumstances around use of the indefinite reversal criterion and reevaluate its use if necessary. A company experiencing cash flow constraints may reevaluate its global cash needs or strategies and revise its plans for repatriating or reinvesting foreign earnings. Additionally, regulatory factors may change and impact tax planning strategies, leading to the need to reassess previous conclusions about repatriation of earnings. [740-30-25-19, 740-30-05-4 – 05-5]

Section 7 of KPMG Handbook, Accounting for income taxes, discusses the impact of foreign operations on accounting for income taxes in additional detail.

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10. Financial statement presentation, disclosures and MD&A

Detailed contents

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10.1 Questions to ask

Economic disruption may create a variety of uncertainties that can impact companies in multiple ways. Some companies may be impacted indirectly from the cascading effect that economic disruption may have on the global supply chain, while others may be more directly impacted. Whether directly or indirectly impacted, companies consider the financial statement presentation or disclosure complexities that could arise from this disruption, including:

- disposals or sales;
- bankruptcy considerations;
- going concern considerations;
- risks and uncertainties; and/or
- subsequent events and unusual or infrequently occurring events or transactions.

Registrants must also consider the effects of economic disruption on their regulatory reporting.

The following are example questions to consider that are specific to economic disruption and the potential impact to financial statement presentation, disclosures and Regulation S-K disclosures outside of the financial statements.

QUESTION	ADDITIONAL INFORMATION
Has the company: • made plans to dispose, or already disposed, of a component or components of its operations; or • sold any of its interest in a previously consolidated company?	Section 10.2
Does the company intend to file a petition for bankruptcy, or has it already done so?	Section 10.3
Has management determined there is substantial doubt about the company's ability to continue as a going concern for the look-forward period?	Section 10.4
Does the economic disruption result in additional or revised disclosures about its significant near-term effects on the following risks and uncertainties: • new or recurring estimates that are sensitive to change; and/or • concentrations in: – customers; – suppliers; – lenders/grantors; – contributors; – geographic regions; – sources of materials;	Section 10.5

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QUESTION	ADDITIONAL INFORMATION
– labor concentrations; and/or – licenses/other rights?	
Has the economic disruption resulted in the occurrence of: • events or transactions after the balance sheet date but before the financial statements are issued (or available to be issued for non-SEC filers); and/or • unusual or infrequent material events or transactions in the reporting period?	Section 10.6
For registrants, has the company considered the effects of economic disruption on its Regulation S-K disclosures outside of the financial statements, including those related to its: • description of business; • description of property; • legal proceedings; • risk factors; • liquidity and capital resources; • results of operations (e.g. has the economic disruption had (or is it likely to have) a material impact on reported (or future) operations); and • critical accounting estimates?	Section 10.7

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10.2 Disposals

When faced with economic disruption, companies may decide to implement a variety of measures or shift strategies. The following are examples of these measures.

- Increased regulation or new policies could lead a company to divest or discontinue operations in a specific jurisdiction or industry segment.
- A natural disaster could lead a company to disband operations and sell remaining assets in that segment.
- Mandatory shutdowns could force a company to shutter a chain of retail stores and lead management to dispose of related assets.
- Cash flows could be strained and may result in the company disposing of assets to generate cash flows.
- To reduce exposure to geopolitical or trade-related risks, supply chains may be reevaluated, resulting in plans to relocate or shut down operations in certain locations.

When asset disposals are one of the measures or strategy shifts management may take in response to economic disruption, consideration must be given to whether the disposal group meets the HFS criteria and/or qualifies for presentation as a discontinued operation. For partial divestitures in subsidiaries or equity method investments, management must also consider revisiting consolidation conclusions.

10.2.10 HFS criteria

There are six criteria in Subtopics 360-10 (property, plant and equipment) and 205-20 (discontinued operations) that must be met for a long-lived asset or disposal group to be classified as HFS. There is no discretion in the classification – an asset or disposal group is classified as HFS in the period in which all of the HFS criteria (see table below) are met. [205-20-45-1E, 360-10-45-9]

Companies also consider the HFS criteria during step 2 of the discontinued operations five-step process discussed in section 10.2.20. [205-20-45-1E]

Held-for-sale criteria	
A.	Management, having the authority to approve the action, commits to a plan to sell the entity to be sold.
B.	The entity to be sold is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such entities to be sold.
C.	An active program to locate a buyer or buyers and other actions required to complete the plan to sell the entity to be sold have been initiated.
D.	The sale of the entity to be sold is probable, and transfer of the entity to be sold is expected to qualify for recognition as a completed sale, within one year.

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Held-for-sale criteria
E. The entity to be sold is being actively marketed for sale at a price that is reasonable in relation to its current fair value.
F. Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

For additional discussion about the HFS criteria, including how to apply them and exceptions to their application, see chapter 4 of KPMG Handbook, Discontinued operations and held-for-sale disposal groups.

If the HFS criteria are met, the following actions are taken as of the reporting date for each disposal group the company intends to sell.

- Write down the disposal group to fair value less cost to sell and recognize any resulting loss (see section 4.5 of KPMG Handbook, Discontinued operations and held-for-sale disposal groups).
- Present the assets and liabilities of the disposal group separately as HFS (see section 6.2 of KPMG Handbook, Discontinued operations and held-for-sale disposal groups).
- Report the disposal group in discontinued operations (as necessary) by applying the five steps in section 10.2.20 or if the disposal group is a business or not for profit activity that is classified as HFS on acquisition (see chapter 5 and section 2.3, respectively, of KPMG Handbook, Discontinued operations and held-for-sale disposal groups).

10.2.20 Discontinued operations

When a disposal group meets the requirements in Subtopic 205-20 to be reported in discontinued operations, it is referred to as a 'discontinued operation', even if it has not yet been disposed of. Discontinued operations are reported separately from continuing operations on the balance sheet and in the income statement and statement of cash flows.

Subtopic 205-20 requires a five-step process to determine if plans to dispose of a part of a company's operations qualify the disposal group as a discontinued operation.

Step 1 – Determine if the disposal group is a component
The unit of account for evaluating whether a disposal group is a discontinued operation is one or more components of a company's continuing operations. [205-20-15-2]
Step 2 – Evaluate HFS criteria if disposal has not yet occurred
The HFS criteria are listed in section 10.2.10. [205-20-45-1E]
Step 3 – Evaluate whether a strategic shift occurred
If step 2 is met, a company then evaluates whether the disposal represents a strategic shift that either has had or will have a major effect on the company's operations and financial results. [205-20-45-1C]

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Step 4 – Present as a discontinued operation
If step 3 is met, the disposal group qualifies as a 'discontinued operation' and is reported separately on the face of the financial statements for the current and comparative periods. [205-20-45-3, 45-3A, 45-3B, 45-10]
Step 5 – Provide relevant disclosures
There are specific qualitative and quantitative disclosures depending on the nature of the discontinued operations. Additional disclosures are also required, for example, when the company retains significant continuing involvement with the discontinued operations after the disposal, or for certain significant disposal groups that do not qualify as discontinued operations. [205-20-50-1 – 50-5D]

For a discussion about applying the steps above, see KPMG Handbook, Discontinued operations and held-for-sale disposal groups.

Exit or disposal activities

Topic 420 includes guidance on accounting for exit and disposal activities, which may become relevant when a company disposes of discontinued operations and covers topics such as costs associated with a disposal activity or a one-time employee termination benefit (see section 8.3.10). [420-10-15-3]

See section 4.6.70 of KPMG Handbook, Employee benefits, for more discussion about other costs associated with exit or disposal activities.

10.2.30 Consolidation and equity method of accounting

Consolidation

During periods of economic disruption, a company may sell interests in its subsidiaries or otherwise modify contracts governing its ability to control or influence its subsidiaries' operations. When one or both of these actions are taken, the company:

- reevaluates the consolidation guidance in Topic 810, including that pertaining to the identification of variable interest entities; and
- evaluates the need to present a noncontrolling interest (if applicable).

See KPMG Handbook, Consolidation, for more information on the consolidation model and practical questions encountered when applying Topic 810.

Equity method of accounting

An investor generally applies the equity method of accounting to its investment when it has the ability to exercise significant influence over the operating and financial decisions of that investee. Determining whether an investor has the ability to exercise significant influence requires an investor to evaluate the individual facts and circumstances related to each investment. In periods of economic disruption, a company's ability to exercise significant influence over its investees may be impacted due to transactions or contractual changes to investment or other agreements.

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See KPMG Handbook, Equity method of accounting, for more information on the equity method of accounting and related practical questions.

10.3 Bankruptcy

In periods of economic disruption, companies may find servicing debts and other liabilities increasingly difficult as cash flows become strained. These liquidity issues may lead certain companies to file for bankruptcy.

To use the bankruptcy process to either restructure debts or settle (liquidate) debts with creditors, companies must first petition the federal government. Courts then determine whether to provide approval to modify, reduce or eliminate debts and supervise the bankruptcy proceedings.

Accounting considerations are different depending on where in the stage of the process the company is.

- **Prior to filing for bankruptcy** – A company applies US GAAP as it otherwise would (see section 10.3.10).
- **After filing for bankruptcy** – The accounting depends on the section of the bankruptcy code under which the petition is filed (see section 10.3.20).
- **Emergence from bankruptcy** – If the company emerges from bankruptcy, it applies fresh-start accounting and then the otherwise applicable US GAAP.

See section 2.3 and chapter 5 of KPMG Handbook, Accounting for bankruptcies, for additional detail on the bankruptcy process and information on emerging from bankruptcy, respectively.

10.3.10 Prior to filing for bankruptcy

Prior to filing a bankruptcy petition, a company continues to follow applicable US GAAP. However, if a bankruptcy petition is imminent, there are several issues under US GAAP that a company considers, including the following.

Issue	Consideration
Impairment of nonfinancial assets	Whether any triggering events are present (see sections 5.2 and 6.2)
Recoverability of inventories	Whether a write down of inventory is necessary (see section 4.4)
Impairment and classification of investments	Whether investments are properly valued and presented (see sections 3.4, 3.6, and 3.7)
Allowance for credit losses	Whether assessment of collectibility is appropriate (see sections 3.2 and 3.3)
Debt classification	Whether all terms, including subjective acceleration clauses, have been identified and appropriately evaluated (see section 7.2)

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Issue	Consideration
TDRs, debt extinguishments and modifications	Whether conclusions reached in TDR analyses are appropriate (see section 7.3)
Derivatives and hedging	Whether the company's own nonperformance risk affects the determination of hedge effectiveness (see section 3.5)

In addition, registrants must consider the related disclosure requirements for each of these issues, as well as the disclosure requirements discussed further in sections 10.4 and 10.5.

While these issues and considerations are highlighted here, the other questions asked in this publication regarding financial reporting during periods of economic disruption are also relevant.

See section 3 of KPMG Handbook, Accounting for bankruptcies, for additional detail.

10.3.20 After filing for bankruptcy

The US Bankruptcy Code provides multiple avenues for companies to file for bankruptcy. For companies that do not qualify as small businesses, Chapter 7 and Chapter 11 are the most common avenues.

Provided below is a summary of both of these avenues. Additional information is provided in section 2.2 of KPMG Handbook, Accounting for bankruptcies.

Chapter 7

Chapter 7 bankruptcy leads to a liquidation of assets to settle liabilities. Companies in Chapter 7 apply Subtopic 205-30 (liquidation basis of accounting). [205-30-05-1]

Subtopic 205-30 requires measurement and presentation on the balance sheet of liquidation-basis assets, liabilities and other liquidation-related accruals. Additionally, it requires companies to, at a minimum, prepare a statement of net assets in liquidation and a statement of changes in net assets in liquidation along with relevant disclosures.

Chapter 11

Chapter 11 bankruptcy is a court-assisted process to restructure and reduce the amount of liabilities in a manner that allows the company to continue to operate during the proceedings. After filing for bankruptcy under Chapter 11, and until emergence from bankruptcy, companies operate as a debtor-in-possession and apply Subtopic 852-10 (reorganizations).

Subtopic 852-10 requires the segregation of liabilities into prepetition and postpetition liabilities. Within prepetition liabilities, liabilities subject to compromise are presented separately on the balance sheet. Gains and losses directly associated with the bankruptcy are reported as reorganization expense. Outside of these incremental requirements, a debtor-in-possession continues to follow other applicable US GAAP.

It is important for the company to ensure that items included in prepetition liabilities and liabilities subject to compromise are appropriately categorized and do not represent postpetition liabilities or ongoing business expenses unrelated to the

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Chapter 11
bankruptcy. This may be particularly challenging when a company is experiencing significant change and unprecedented expenses in a period of economic disruption. See chapter 3 of KPMG Handbook, Accounting for bankruptcies, for more information on identifying and measuring the amounts included in liabilities subject to compromise and reorganization expense. That chapter also addresses other bankruptcy specific nuances that debtors-in-possession must consider in the presentation of their financial statements.

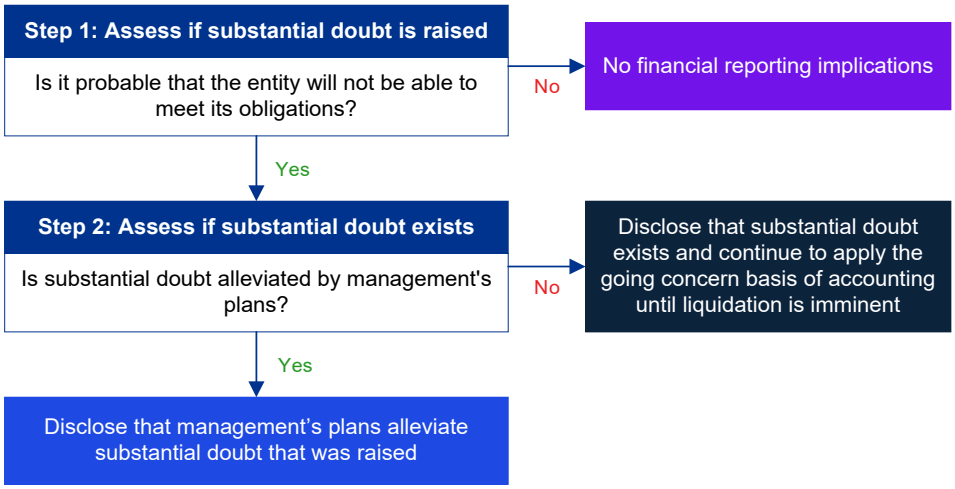
10.4 Going concern

When faced with challenges associated with economic disruption, companies may face liquidity challenges and difficulties in meeting their obligations.

Management is required to assess the company's liquidity and ability to continue as a going concern. As described below, this assessment could result in required financial statement disclosures to assist the users of those financial statements in fully understanding a company's liquidity position and its ability to continue as a going concern.

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 (or available to be issued for non-SEC filers) – 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.

Management is required to perform a going concern assessment each reporting period. This two-step assessment is summarized as follows. [205-40-50-1]



As noted in the diagram, disclosure is required for the results of Step 2, but the nature of the required disclosure depends on the results of the assessment.

In a period of economic uncertainty, management's going concern assessment can be more complex and require additional judgment. Determining whether it is probable that the company will be unable to meet its obligations (Step 1) is

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based on known and 'reasonably knowable' conditions and events that exist when the financial statements are issued (or available to be issued for non-SEC filers). For example, evolving tariff and trade policies or uncertainty about related mitigation strategies may add complexity and require increased judgment in the going concern assessment. In such cases, management may need to perform additional forecasting and may benefit from preparing sensitivity analyses on significant assumptions to aid in supporting the probability of results in varying market conditions.

When substantial doubt is raised, it can be alleviated if management has sufficient mitigation plans in place. Management's plans are only considered when it is probable that within the look-forward period: [205-40-50-7 – 50-8]

- the plans will be effectively implemented – these plans must be approved before the financial statements are issued (or available to be issued for non-SEC filers) and considered feasible; and
- the plans will mitigate the relevant conditions or events that raise substantial doubt.

Management may have a history of successfully forecasting and executing similar plans (e.g. restructuring or refinancing plans), which would normally be indicative of the feasibility of current plans. However, in periods of economic disruption, it may not be appropriate to rely on past history to establish future expectations. It may also be difficult to establish the probability of a plan's future success when critical elements of the plan depend on events outside management's control – e.g. availability of credit lines, general market rebound, ability to secure other financing.

See KPMG Handbook, Going concern, for an in-depth look at management's going concern assessment and the disclosures required.

Going concern may affect other accounting treatments

Management must take the going concern assessment, including plans to alleviate substantial doubt, into consideration when performing other accounting evaluations. For example, when substantial doubt is raised, the following accounting issues may arise.

- Certain future forecasted transactions may no longer be probable of occurring, which could require related hedging relationships to be reassessed (see section 3.5).
- Forecasted debt covenant violations may require current versus noncurrent debt classification to be revisited (see section 7.2.10). For example, a company's debt agreement may contain a covenant that restricts it from receiving an audit report on its annual financial statements that contains a going concern explanatory paragraph.

See section 6.1 of KPMG Handbook, Going concern, for a detailed discussion of other accounting matters potentially impacted by the going concern assessment.

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10.5 Risks and uncertainties

During periods of economic disruption, disclosures about risks and uncertainties may become more valuable to financial statement users. However, they may also become more difficult for management to prepare due to the potentially significant impacts of the economic disruption on the company's business. The risks the company has historically faced may have changed and/or there may be new risks. For example, a company may have new or changed risks related to: litigation; the availability of materials, a qualified workforce or capital; or the imposition of new or evolving tariffs or trade policies that affect sourcing strategies, cost structures or customer pricing. In addition, these risks can be specific to the company, or they can affect the company's industry and the business climate in which the company operates.

When preparing disclosures about risks and uncertainties, management must consider:

- any new risks and uncertainties arising from specific current events, and how the company plans to address these risks; and
- the possibility of repeating and updating disclosures about risks and uncertainties at each interim period to provide transparency and fair presentation.

Topic 275 requires disclosure of risks and uncertainties that could significantly affect:

- the amounts reported in the financial statements in the near term; or
- the near-term functioning of the company.

The economic disruption affecting companies may require additional or revised disclosures about risks and uncertainties to discuss the significant near-term effects of the disruption. These disclosures are incremental to the disclosure requirements about going concern (see section 10.4) and include disclosures addressing certain estimates and significant concentrations in the company's operations. [275-10-05-02]

Considerations related to the types of disclosures required by Topic 275 are provided in the following table.

Type	Considerations
Nature of operations/ activities	If a company has commenced planned principal operations, its financial statements must include a description of the major products or services it sells or provides and its principal markets, including the locations of those markets. [275-10-05-07] This disclosure may need to be closely examined in periods of economic disruption, especially if the company is shifting strategic priorities or exiting certain regions.
Estimates	Estimates inherent in the current financial reporting process inevitably involve assumptions about future events. [275-10-05-07]

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Type	Considerations
	The financial statements must include a discussion of those estimates for which it is reasonably possible that a material change could occur in the near term. [275-10-50-6] Examples of items to evaluate are: • new characteristics of uncertainty in revenue forecasts, sourcing and workforce availability, credit ratings, etc.; and • volatility in stock and commodity prices, interest rates and currency exchange rates. Companies identify not only the estimates sensitive to change, but also explain the reason for the underlying uncertainty and potentially quantify the possible loss or range of loss for certain estimates. [275-10-50-9]
Current vulnerability due to certain concentrations	Current vulnerability due to certain concentrations must be disclosed. [275-10-05-08] Examples of these concentrations include: • the volume of business transacted with a particular customer, supplier, lender, grantor or contributor; • the revenue from particular products, services or fund-raising events; • the available sources and supply of materials, labor or services, or licenses or other rights used in the company's operations; and • the market or geographic area in which a company conducts its operations. In periods of economic disruption, companies may be experiencing significant change in the nature of their products, services, customer base, geographic footprint, vendors, etc. Changes in operations such as these may lead to difficulty in preparing the necessary disclosure and keeping the disclosure updated from period to period.

See chapter 7 of KPMG Handbook, Financial statement presentation, for a detailed discussion of disclosures related to risks and uncertainties.

10.6 Subsequent events and unusual items

In normal course, it is important to remain cognizant of events that occur after the reporting date or that are unusual because these items may trigger additional reporting requirements. During times of economic disruption, companies may be faced with rapid and unprecedented change, making compliance with these requirements more challenging.

10.6.10 Subsequent events

Subsequent events are events and transactions that occur after the balance sheet date but before the financial statements are issued (or available to be

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issued for non-SEC filers). Subsequent events may require disclosure to keep the financial statements from being misleading, and possibly recognition.

Subsequent events are categorized into two broad types.

Recognized events (Type 1)	Nonrecognized events (Type 2)
• Events or transactions that provide additional evidence about conditions that *existed* at the reporting date. • Require adjustment to the financial statements to reflect the impact of events or transactions, and possible specific disclosures.	• Events that provide evidence about conditions that *did not exist* at the reporting date but arose subsequent to that date. • May require disclosure in the notes but the financial statements are not adjusted.

See chapter 9 of KPMG Handbook, Financial statement presentation, for a detailed discussion about subsequent events.

10.6.20 Unusual or infrequently occurring items

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

The term 'unusual nature' represents a situation in which the underlying event has a high degree of abnormality and is not related to the ordinary activities of the company. The term 'infrequency of occurrence' represents an event that would not reasonably be expected to recur in the foreseeable future. [220-20 Glossary]

Specific events giving rise to or occurring as a result of economic disruption may represent an unusual item for some companies. However, judgment is needed to determine the financial effects of these events. Subtopic 220-20 (unusual or infrequently occurring items) is silent on how to determine which losses and costs are attributable to the event. We believe that a reasonable approach is to include direct and incremental costs or gains associated with these events. For example, in the event of an armed conflict, there could be property damage and incremental operating expenses for staff security and evacuation. Normal recurring expenses that would be incurred regardless of these events occurring are typically not direct and incremental – e.g. regular payroll costs, overheads, depreciation expense.

See section 4.4 of KPMG Handbook, Financial statement presentation, for a detailed discussion of unusual or infrequently occurring items.

10.7 Considerations specific to registrants

Reg S-K applies to registrants and requires qualitative disclosures in filings that are incremental to the disclosure requirements of US GAAP. Economic disruption can impact registrants in a variety of ways, which may require these disclosures to be revised.

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Considerations related to certain items in Reg S-K are provided in the following table.

Reg S-K	Considerations related to impacts of economic disruption (not exhaustive)
Item 101: Description of business	Were there any material changes to: • the segments identified; • the business strategy or how the registrant intends to do business in the future; • the registrant's bankruptcy status or the bankruptcy status of any of the registrant's subsidiaries; or • the registrant's organizational structure (e.g. mergers)? Were there any acquisitions or divestitures?
Item 102: Description of property	Were there any material changes to: • the location of the registrant's principal physical properties; or • the general character of the registrant's principal physical properties?
Item 103: Legal proceedings	Were there any material changes to: • material pending legal proceedings, other than ordinary routine litigation incidental to the business; or • material bankruptcy, receivership or similar proceedings with respect to the registrant or any of its significant subsidiaries?
Item 105: Risk factors	Were there material changes to existing risk factors that are relevant to the registrant, either through the impact that the potential risk has on the registrant or the nature of the potential risk? What is the impact of new risk, which is added to risk factors for new or evolved types of economic disruption (e.g. new regulation, cyberattacks, civil unrest)?

In addition, Reg S-K Item 303 provides guidance regarding required MD&A disclosures in the following three categories:

- liquidity and capital resources;
- results of operations; and
- critical accounting estimates.

Each category is discussed in more detail below. In periods of economic disruption, registrants must review these disclosures in detail and revise or supplement them as necessary to reflect the evolving business landscape.

Liquidity and capital resources

Reg S-K Item 303 requires MD&A disclosures about liquidity and capital resources to inform users of the registrant's financial position. The required disclosures include descriptions and amounts of matters that have had a material impact on reported operations, as well as matters that are reasonably likely to have a material impact on future operations. [Reg S-K Item 303(a)]

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The rule requires management to disclose the registrant's ability to generate and obtain adequate amounts of cash to meet current cash requirements and plans for cash in the short-term (i.e. the next 12 months from the most recent fiscal period end required to be presented) and separately in the long-term (i.e. beyond the next 12 months). It also requires an MD&A discussion about material cash requirements from known contractual and other obligations. [Reg S-K Item 303(b)(1)]

Disclosures are required about any known material trends related to the registrant's capital resources, material changes in the mix and relative cost of such capital resources and the registrant's material cash requirements. [Reg S-K Item 303(b)(1)(ii)]

Results of operations

Reg S-K Item 303 requires MD&A disclosures about the results of operations to inform users about relevant information pertinent to the financial results of the business. The rule requires management to disclose and provide additional detail describing items such as (not exhaustive): [Reg S-K Item 303(b)(2)]

- any unusual or infrequent events or transactions or any significant economic changes that materially affected the amount of reported income from continuing operations;
- any known trends or uncertainties that have had or that are reasonably likely to have a material impact on net sales or revenues or income from continuing operations; and
- material changes from period to period in net sales or revenue, if applicable, including price and volume variance information.

Critical accounting estimates

Reg S-K Item 303 requires MD&A disclosure of critical accounting estimates. Critical accounting estimates are those estimates made in accordance with US GAAP that involve a significant level of estimation uncertainty and have had or are reasonably likely to have a material impact on the registrant's financial condition or results of operations. To the extent the information is material and reasonably available, a registrant needs to disclose in MD&A qualitative and quantitative information necessary to understand the estimation uncertainty and the impact the critical accounting estimate has had or is reasonably likely to have on the company's financial condition or results of operations. This information should include why each critical accounting estimate is subject to uncertainty and how much each estimate and/or assumption has changed over a relevant period. The disclosure should also include the sensitivity of the reported amount to the methods, assumptions and estimates underlying its calculation. [Reg S-K Item 303(b)(3)]

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11. Government grants and assistance **

New chapter added in this edition **

Detailed contents

11.1 Questions to ask

11.2 Identifying applicable guidance

11.3 Accounting models for government grants

11.4 Disclosure requirements

11.5 Future developments

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11.1 Questions to ask

In periods of economic disruption, government assistance programs – including grants, forgivable loans, tax incentives and other subsidies – may expand or emerge quickly as governments act to support liquidity, investment and employment. Companies may receive government assistance for the first time or participate in programs that are rapidly introduced or modified. As a result, companies may need to:

- put mechanisms in place to identify these arrangements and any changes to them;
- determine whether they have an existing accounting policy and, if not, establish and consistently apply an appropriate one; and
- evaluate the related disclosure requirements.

Before ASU 2025-10, Government Grants (Topic 832): Accounting for Government Grants Received by Business Entities (see section 11.5), US GAAP did not contain specific recognition and measurement guidance for government assistance received by business entities. ASU 2025-10 introduced such guidance for the first time and becomes effective for calendar year-end public business entities in 2029 and for all other calendar year-end entities in 2030. Until a company adopts the ASU, the guidance discussed in sections 11.2 to 11.4 continues to apply.

The following are examples of questions to consider that are specific to economic disruption and the potential impact to government assistance and associated accounts (not exhaustive).

QUESTION	ADDITIONAL INFORMATION
Has the company received, or become entitled to receive, government assistance (e.g. a grant, forgivable loan, tax incentive or subsidy)?	Section 11.2
Could the government assistance fall within the scope of specific authoritative guidance (e.g. industry-specific guidance, Topic 606 (revenue), Topic 740 (income taxes), Topic 470 (debt), Topic 825 (financial instruments))?	Section 11.2
Does the company need to establish an appropriate accounting policy for government assistance not addressed by other authoritative guidance?	Section 11.3
Have changes in economic conditions affected the company's ability to satisfy grant conditions or its assessment of whether assistance should be recognized or repaid?	Section 11.3
Does the company have government assistance subject to the disclosure requirements of Topic 832?	Section 11.4

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QUESTION	ADDITIONAL INFORMATION
Will the adoption of ASU 2025-10 affect the company's accounting policies and disclosures for government assistance?	Section 11.5

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11.2 Identifying applicable guidance

Government assistance can take many forms, including grants, forgivable loans, tax incentives and other subsidies. Before the issuance of ASU 2025-10 (see section 11.5), US GAAP did not provide comprehensive recognition and measurement guidance for government grants received by business entities. This lack of guidance has led to diversity in practice, with business entities applying other US GAAP or IFRS® Accounting Standards by analogy. This diversity continues to some extent as of the date of this publication because the amendments in ASU 2025-10 are not yet *mandatorily* effective.

A company first determines whether other authoritative US GAAP applies to government assistance before considering the accounting models discussed in section 11.3.

- **Industry-specific guidance** – If applicable industry-specific guidance exists, that guidance governs the accounting. Examples of such guidance include:
  - Subtopic 905-605 for agricultural subsidies;
  - Subtopic 912-730 for best-efforts research and development arrangements sponsored by the federal government; and
  - Subtopic 958-605 for contributions to not-for-profit entities.
- **Exchange transactions** – If an arrangement involves consideration for goods or services that are an output of the company's ordinary activities, the company evaluates whether Topic 606 applies. An arrangement with a payment from a government may be in the scope of Topic 606 even when the government is not itself the customer, such as when the payment is made by a government on behalf of a customer. See section 2.2 of KPMG Handbook, Revenue recognition, for further guidance.
- **Income tax items** – Assistance in the form of tax credits or deductions that reduce a company's income tax liability is evaluated to determine whether Topic 740 applies. Tax credits require further analysis based on how the credit can be monetized and other relevant terms. See chapters 3 through 5 of KPMG Handbook, Tax credits, for further discussion.
- **Debt, guarantees and financing arrangements** – A company applies its accounting policy based on one of the government grant accounting models discussed in section 11.3 to forgivable loans from a government if it expects to meet the conditions for loan forgiveness. Otherwise, the company accounts for the loan under Topic 470 (debt). Other arrangements structured as loans, loan guarantees or other financing arrangements are evaluated under the applicable debt and financial instruments guidance.

Economic disruption may increase the number and variety of government programs available to a company. Accordingly, identifying all forms of government assistance may require coordination among accounting, tax, legal and operational functions, including functions in different jurisdictions.

If government assistance is not addressed by other authoritative US GAAP, a company establishes an accounting policy by analogy under Topic 105 (GAAP).

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Once selected, the accounting policy is applied consistently to similar types of government assistance.

11.3 Accounting models for government grants

If no specific authoritative guidance applies, a company considers the nature and terms of the grant and its existing accounting policies when determining which guidance to apply by analogy. Companies that have not previously received government grants may need to develop new accounting policies and procedures, and significant judgment may be required to account for newly implemented government programs. In practice, companies have applied a number of accounting models by analogy, including those discussed below.

Grant model (analogy to IFRS Accounting Standards)

Under IAS 20, Accounting for Government Grants and Disclosure of Government Assistance, a grant is not recognized until there is reasonable assurance that: [IAS 20.7]

- the company will comply with the grant's conditions; and
- the grant will be received.

In applying IAS 20 by analogy, we understand the SEC staff equates 'reasonable assurance' with the US GAAP concept of 'probable'. Grant income is generally recognized on a systematic basis over the periods in which the related costs are recognized as expenses.

During periods of economic disruption, significant judgment may be required to assess whether it is probable that the company will satisfy the grant conditions and receive the assistance, particularly when new programs are introduced or existing programs are modified in response to changing, or unprecedented, economic conditions. A company also reassesses whether subsequent changes in circumstances affect amounts previously recognized. For example, if economic disruption affects the company's ability to satisfy an employee-retention or spending requirement, the company evaluates whether previously recognized assistance has become repayable.

Contribution model (analogy to Subtopic 958-605)

Although Subtopic 958-605 excludes transfers from governmental entities to business entities from its scope, the FASB staff has noted that business entities are not prohibited from applying this guidance by analogy. Under this approach, grant income is generally not recognized until the conditions on which the assistance depends have been substantially met. [958-605-25-11]

During periods of economic disruption, determining when those conditions have been substantially met may require significant judgment, particularly when assistance programs contain multiple barriers or compliance requirements or when those barriers or requirements are rapidly modified.

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Gain contingency model (analogy to Subtopic 450-30)

Some companies have applied gain contingency accounting to government assistance by analogy to Subtopic 450-30. Under this approach, a company does not recognize income related to a grant or other government assistance until it is realized or realizable. [450-30-25-1]

During periods of economic disruption, a company may receive government assistance before the gain is realized or realizable. For example, cash received may be subject to refund because realization depends on the company's future performance or events outside its control. See section 6.3 of KPMG Handbook, Contingencies, commitments and guarantees, for additional guidance.

Other analogies

Other analogies may be acceptable based on the facts and circumstances and the guidance hierarchy in Topic 105. For example, some companies have developed an accounting policy by analogizing to aspects of Topic 606.

11.4 Disclosure requirements

During periods of economic disruption, government assistance may become increasingly significant to a company's liquidity, operating results and financial position. Rapidly introduced or modified programs may also make it more challenging to identify all government assistance and disclose its significant terms and financial statement effects.

For annual periods, Topic 832 requires the following disclosures for transactions with a government that are accounted for by applying a grant or contribution model by analogy: [832-10-50-3, 50-4]

- the nature of the transactions, including a general description of the transactions and the form in which the assistance was received (e.g. cash or other assets);
- the accounting policies used to account for the transactions;
- the line items on the balance sheet and income statement that are affected and the amounts applicable to each financial statement line item in the current reporting period; and
- significant terms and conditions of the transactions, including, but not limited to, the duration or period of the agreement, commitments made by both parties, other contingencies, and any other provisions that would allow the government entity to recapture the amounts awarded.

Government assistance that is not accounted for under a grant or contribution model (i.e. it is accounted for under a gain contingency model, by analogy to Topic 606 or under other guidance) is outside the scope of Topic 832. For this government assistance, a company applies the disclosure requirements of the accounting guidance used.

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During periods of economic disruption, companies may need to reassess both the completeness of the government assistance they have identified and the adequacy of their related disclosures as new programs are introduced or modified.

See KPMG Issues In-Depth, Government assistance disclosures, for additional guidance.

11.5 Future developments

On December 4, 2025, the FASB issued ASU 2025-10, establishing authoritative guidance for the recognition, measurement and presentation of government grants received by business entities. The guidance applies to all entities except not-for-profit entities and employee benefit plans.

The ASU changes the name of Topic 832 from 'Government assistance' to 'Government grants' and expands Topic 832 to do the following:

- prescribe an accounting model based on the main principles in IAS 20, with revisions to areas such as scope and the recognition threshold;
- define a government grant as a transfer of a monetary or tangible nonmonetary asset, other than an exchange transaction, from a government to a business entity;
- provide a recognition threshold under which a grant is recognized only when (1) it is probable that the entity will comply with the grant's conditions and that the grant will be received and (2) the entity meets the specific recognition guidance for a grant related to an asset or a grant related to income;
- leverage existing disclosure requirements in Topic 832 for annual periods; and
- create specific recognition and measurement guidance in Topic 805 for certain government grant-related liabilities assumed in a business combination.

The ASU is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2028, with a one-year deferral for entities other than public business entities. Early adoption is permitted. Entities may elect to apply the guidance using a modified prospective, modified retrospective or full retrospective transition approach.

See KPMG Defining Issues, FASB issues ASU on accounting for government grants, for additional discussion.

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Index of changes

This index lists the significant changes made in this edition to assist you in locating recently updated content. New content added in this edition is identified throughout the Handbook with ** and content that has been significantly updated or revised is identified with #.

1. Executive summary

What are the effects of economic disruption? #

How is financial reporting affected by economic disruption? #

6. Long-lived assets, leases and equity method investments

6.4 Equity method investments #

7. Liabilities

7.3.10 Determining how to account for a debt modification #

8. Compensation and benefits

8.2 Share-based payments

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Performance conditions #

Market conditions #

8.2.20 Modifications #

8.3 Employee benefits

8.3.10 Termination benefits #

Involuntary termination benefits #

8.3.20 Defined benefit plans #

Interim remeasurement #

11. Government grants and assistance **

[All content in this chapter is new.]

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- Accounting for economic disruption
- Asset acquisitions
- Bankruptcies
- Business combinations
- Business combinations (SEC reporting)
- California climate laws
- Climate risk in the financial statements
- Consolidation
- Contingencies, commitments and guarantees
- Credit impairment
- Crypto assets
- Debt and equity financing
- Derivatives and hedging
- Discontinued operations and held-for-sale disposal groups
- Earnings per share
- Employee benefits
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