Real estate accounting and reporting

The impact of new standards and guidance 2022 report

November 2022

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

Following the tradition of this report, we provide key reminders for certain guidance including equity method investments, reference rate reform, and simplifications to accounting for income taxes; reminders and changes to the leasing standard along with new guidance such as accounting simplification for convertible instruments; and proposed guidance, including the simplification for private companies to determine the fair value of share-based awards.

Each year, we also highlight the themes that are top of mind to the real estate industry and share associated technical insights. As the real estate industry continues to navigate Environmental, Social, and Governance (ESG) related matters, we focus on the key financial accounting and reporting implications related to climate change.

On the topic of ESG and its growing significance to the real estate industry, there has been a collective movement orchestrated by standing National Council of Real Estate Investment Fiduciaries (NCREIF) and Pension Real Estate Association (PREA) committees and the Reporting Standards to work towards reporting guidance. After obtaining feedback throughout 2021, the NCREIF PREA Reporting Standards recently announced the release of ESG Principles of Reporting for Private Real Estate. We are proud that KPMG was represented in the committees supporting the creation of these principles and refer readers to this guidance.

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

Thank you.

Greg Williams
National Sector Leader
Asset Management/Building, Construction & Real Estate
KPMG LLP
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**It’s Here! – Private entities adopt the leases standard**
Calendar year-end private entities were required to adopt Topic 842 on January 1, 2022. Non-calendar year-end private entities are required to adopt on the first day of their fiscal year beginning after January 1, 2022 (e.g. April 1, 2022 for a private entity with a March 31 year-end).

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

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

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

- the remaining ‘minimum rental payments’ (as defined under Topic 840); and
- amounts probable of being owed by the lessee under a residual value guarantee.

The minimum rental payments for a lease under Topic 840 include those payments due over the accounting ‘lease term’, which may extend beyond the non-cancellable period of the lease.

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

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

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

- identifying all of the entity’s leases, including embedded leases;
- abstracting the lease data necessary to account for leases under Topic 842 and make the required disclosures; and
- determining the discount rate for lessee leases (which may be partially, or even substantially, mitigated for private entities that elect to use the ‘risk-free discount rate’ practical expedient for most or all their leases).
KPMG has several Topic 842 resources, including KPMG Handbook: Leases and a suite of Hot Topics that target common implementation challenges.

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

Equity Method Investments

The Financial Accounting Standards Board (FASB) issued an accounting standard¹ which clarifies the interactions between Accounting StandardsCodification (ASC) 321, ASC 323, and ASC 815. The new guidance addresses accounting for the transaction into and out of the equity method.

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

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

Policy election not to allocate consolidated income taxes

The FASB issued guidance² to simplify accounting for income taxes, change the accounting for certain income tax transactions, and make minor improvements to the Codification. The ASU introduces new guidance which provides a policy election to not allocate consolidated income taxes when a member of a consolidated tax return is not subject to income tax and provides guidance to evaluate whether a step up in tax basis of goodwill relates to a business combination in which book goodwill was recognized or should be accounted for as a separate transaction.

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

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

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

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¹ FASB ASU No. 2020-01, Clarifying the interactions between Topic 321, Topic 323, and Topic 815
² FASB ASU No. 2019-12, Simplifying the Accounting for Income Taxes
Accounting reminders – Effective in 2022, or later for certain private companies

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

Disclosures for business entities receiving government assistance

In November 2021, the Financial Accounting Standards Board (FASB), issued guidance\(^3\) that created Topic 832, Government Assistance, which requires business entities to disclose information about certain government assistance that they receive. Not-for-profit entities and employee benefit plans are automatically exempt from the new disclosure requirements. Entities must comply with the new disclosure requirements if they account for transactions with government entities under the (1) contribution model (e.g. Subtopic 958-606) or (2) grant model (e.g. IAS 20) by analogy.

The Topic 832 disclosure requirements include:

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

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

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

Lessors—Certain leases with variable lease payments

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

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

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

\(^3\) FASB ASU No. 2021-10, Disclosures by Business Entities about Government Assistance

\(^4\) FASB ASU No. 2021-05, Leases (Topic 842): Lessors – Certain Leases with Variable Lease Payments
The guidance became effective for annual periods for all entities in fiscal years beginning after December 15, 2021. The guidance became effective for interim periods for public business entities in fiscal years beginning after December 15, 2021, and will become effective for interim periods for all other entities in fiscal years beginning after December 15, 2022.

**Convertible debt and contracts in own equity**

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

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

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

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

The new guidance is effective for Securities and Exchange Commission (SEC) filers that are not smaller reporting companies for annual and interim periods in fiscal years beginning after December 15, 2021. For other entities, it is effective for annual and interim periods in fiscal years beginning after December 15, 2023. Early adoption is permitted, but no earlier than fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. An entity should adopt the guidance at the beginning of its annual fiscal year.

5 FASB ASU No. 2020-06, Accounting for Convertible Instruments and Contracts in an Entity’s Own Equity
Looking ahead to new standards and guidance

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

**Certain LIBOR settings are no longer published**
ICE Benchmark Administration Limited (IBA, LIBOR’s administrator) has taken the following actions.

<table>
<thead>
<tr>
<th>Action</th>
<th>Relevant settings</th>
</tr>
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<tbody>
<tr>
<td>Ceased publishing certain LIBOR settings after December 31, 2021.</td>
<td>1-week and 2-month USD LIBOR settings (these are two lesser-used USD LIBOR settings) and all GBP, EUR, CHF and JPY LIBOR settings.</td>
</tr>
<tr>
<td>Began publishing ‘synthetic’ LIBOR1 for certain settings with effect from January 1, 2022; IBA is required to publish these settings through 2022.</td>
<td>1-, 3- and 6-month GBP and JPY LIBOR.</td>
</tr>
<tr>
<td>Announced in March 2021 that it intends to stop publishing the remaining LIBOR settings after June 30, 2023.</td>
<td>Overnight, 1-month, 3-month, 6-month and 12-month USD LIBOR settings; these are the major USD LIBOR settings.</td>
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**FASB amends TDR guidance and enhances disclosures**
For entities that have adopted the credit impairment standard (Topic 326), new guidance makes various changes to US GAAP, primarily relating to loan modifications and disclosures. The new guidance:

- Requires expected credit losses measured under a discounted cash flow (DCF) method to be determined using an effective interest rate based on the receivable’s modified (not original) contractual terms for all modified receivables; a DCF (or reconcilable) method is no longer required for any modified receivables.
- Enhances disclosures by creditors for modifications of receivables from debtors experiencing financial difficulty in the form of principal forgiveness, an interest rate reduction, an other-than-insignificant payment delay or a term extension.

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3 FASB ASU No. 2021-10, Disclosures by Business Entities about Government Assistance
4 FASB ASU No. 2021-05, Leases (Topic 842): Lessors – Certain Leases with Variable Lease Payments
• Augments existing disclosures by requiring creditors that are public business entities to disclose current-period gross writeoffs by year of origination (i.e. the vintage year) for financing receivables and net investments in leases.

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

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

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

FASB expands fair value hedge accounting

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

• allow non-prepayable financial assets to be included in the closed portfolio;
• expand the current single-layer model to allow multiple hedged layers of a single closed portfolio;
• clarify that fair value basis adjustments in an existing portfolio layer method hedge are maintained at the closed portfolio level (i.e. not allocated to individual assets);
• prohibit an entity from considering fair value basis adjustments related to a portfolio-layer method hedge when estimating credit losses;
• address how an entity accounts for fair value basis adjustments when discontinuing a portfolio-layer method hedge;

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

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

7 FASB ASU No. 2022-01, Fair Value Hedging – Portfolio Layer Method
Proposed guidance and emerging matters

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

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

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

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

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

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

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

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

• cybersecurity incidents in periodic reports;
• cybersecurity risk management policies and strategy; and
• cybersecurity oversight by the board of directors and the directors’ expertise.

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

Proportional amortization method election
The FASB has issued a proposed ASU that would allow companies to apply the proportional amortization method (PAM) to all qualifying investments, regardless of the type of tax credit program. Companies would be allowed to elect the PAM for qualifying investments on a tax credit-program by tax credit-program basis.
The proposal would clarify that when evaluating the PAM’s ‘qualification criteria’, companies would:

- assess whether substantially all of an investment’s projected benefits are from tax credits and other tax benefits on a discounted basis using a discount rate consistent with the investor’s cash flow assumptions;
- treat refundable tax credits as non-tax benefits;
- include all tax benefits, refundable tax credits, and non-tax cash flows in the identification of total projected benefits; and
- assess ‘significant influence’ in relation to the operations of the underlying project.

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

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

**ESG Developments**

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

**Climate risk**

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

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

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

**Funds and investment advisers**

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

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

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

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

The new laws also introduce mechanisms for monetizing some credits that are novel to US tax law – including elections for ‘direct pay’ and third-party transfer. The IRA also allows for bonus credits if a company meets certain criteria.

Accounting impacts

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

Considerations for preparers include the following.

- **15% Corporate AMT.** Companies should account for the incremental tax owed under the Corporate AMT as it is incurred and continue to measure their deferred taxes at regular tax rates – at enactment and going forward. A company’s AMT status also may affect its ability to realize deferred tax assets under the regular tax system. The Corporate AMT is effective for tax years beginning after December 31, 2022.

- **1% excise tax on stock repurchases.** The excise tax is levied on a non-income-based measure and is therefore not in the scope of Topic 740 (income taxes).

- **New options for monetizing certain tax credits.** Companies in the energy space may elect a transferability election through which they can sell certain tax credits to third parties. In addition, both the IRA and CHIPS introduce a direct pay mechanism for certain credits and certain taxpayers under which the credits are considered a direct payment of tax and are refundable. The accounting for these credits will depend on whether they (1) are dependent on a company’s ongoing tax status or tax position, (2) may be sold and (3) are likely to be sold.

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

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