



Hot Topic: Coronavirus

Compensation and benefit arrangements and related accounting implications

March 23, 2020 (Updated April 15, 2020¹)



KPMG highlights potential accounting implications of COVID-19 on various compensation and benefit arrangements.



Background

The COVID-19 outbreak is having a significant impact on global markets driven by supply chain and production disruptions, workforce restrictions, travel restrictions, reduced consumer spending and sentiment, amongst other factors, which are negatively impacting companies' financial performance.

As a result of the impacts of COVID-19, companies are taking actions that have an impact on financial reporting, such as providing revised or new compensation arrangements, evaluating existing compensation arrangements to determine if any specific terms, conditions or estimates have been affected, and/or making modifications to compensation and benefit arrangements. In addition, companies may enter into workforce actions that could result in pension or postretirement curtailments or settlements or the need to pay severance and other postretirement benefits.

Questions that companies may be asking include the following.

- Has market volatility affected the likelihood of achieving market conditions in stock-based awards?
- Do we need to reassess the probability of stock-based awards with performance conditions?
- Are we considering modifying share-based payment awards to change certain terms and conditions, such as vesting criteria or strike prices?
- For new or modified awards, are we considering including some discretionary performance conditions due to the significant uncertainty in our future performance?
- Have we implemented a restructuring plan that includes termination benefits?
- Have employee terminations or other actions created a significant event requiring an interim remeasurement of our pension or postretirement plan assets and obligations?
- Has the company implemented new or revised sick leave or paid time off policies to respond to employee needs?

¹ New guidance or significant updates are indicated with **

If the answer to any of these question is 'yes', further consideration may be needed to determine if there are accounting implications.

Share-based payments

Depending on the nature of the terms and conditions of a share option award, changes in the market and a company's performance may have a significant effect on the accounting for share-based payment awards.

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: [\[718-10-30-12\]](#)

- rendering services or delivering goods for an explicit or implicit period of time; and
- achieving a specified performance target that is defined 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. Due to recent current events in the market, the probability assessment of performance based awards should be reevaluated to determine if a reversal of compensation expense is required. [\[718-10-25-20\]](#)

For further discussion, see paragraph 4.102 of KPMG's Handbook, [Share-based payment](#).

Market conditions

A market condition relates to the achievement of a specified price of the issuer's shares, or a specified amount of intrinsic value indexed to the issuer's shares, or a specified price of the issuer's shares in terms of similar equity shares. [\[718-10-30-14\]](#)

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 may result in the market condition not being achieved, this uncertainty is accounted for in the initial valuation performed; as a result, the related compensation cost is still recognized if the service conditions are met by the grantee. [\[718-10-30-14\]](#)

For further discussion, see paragraph 4.108 of KPMG's Handbook, [Share-based payment](#).

Modifications

With the significant volatility in the global markets as a result of COVID-19, companies may begin reevaluating their existing share options with service, performance and/or market conditions. 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 or after the modification. [\[718-20-35-2A – 35-9\]](#)

The following are example modification scenarios (not exhaustive) that may arise in the current environment.

Modifications of performance conditions

Performance conditions may be modified in the current quarter due to changes in the probability of the performance condition being met (e.g. revised revenue targets). A change in a performance condition results in modification accounting.

Repricing of awards	When a share-based payment award is repriced, the fair value of the award is changed and modification accounting is applied.
Modifications of awards with market conditions	When a market condition in an award is modified, the probability of satisfying the original 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.
Accelerated vesting of awards	When the vesting of a share-based payment award is accelerated, the 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 an acceleration clause, modification accounting is applied at the time of the acceleration.
Discretionary clause or claw back provision	<p>Discretionary clauses provide latitude to compensation committees – e.g. they allow the committees to claw back a previously vested award or to subjectively determine whether a performance condition has been achieved. If the discretionary clause provides compensation committees with significant subjectivity, there may be no shared understanding of the terms and conditions. In that case a grant date has not been established, impacting both the measurement date and the attribution period. [718-10-55-108]</p> <p>In addition, modification accounting is applied if a discretionary clause is invoked for changes other than predetermined adjustments – e.g. changes in capital structures or the recalculation of performance requirements.</p>

For further discussion, see section 5 of KPMG's Handbook, [Share-based payment](#).



Termination benefits

Voluntary termination benefits

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 also can result in an interim remeasurement of postretirement benefit plan assets and obligations as a significant event. See below, *Retirement benefits: Interim remeasurements*. [712-10-25-1, 715-30-25-10]

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 following table helps determine which Topic applies, depending on the type of involuntary benefit offered. [712-10-15-4]

Type of benefit	Applicable ASC Topic
Termination benefits paid under an ongoing termination benefit arrangement. This is specific to base termination benefits only; see the treatment for enhanced benefits under Topic 420.	Topic 712, Compensation—Nonretirement Postemployment Benefits
Any enhanced benefits made to an existing arrangement or one-time termination benefits paid in connection with an exit activity.	Topic 420, Exit or Disposal Cost Obligations
Contractual termination benefits that are paid only if a specified event occurs (e.g. plant closings).	Topics 712 and 715, Compensation—Retirement Benefits
Termination benefits provided through a pension or postretirement benefit plan due to a specified event occurring (e.g. plant closings).	Topic 715, Compensation—Retirement Benefits
Termination benefits that meet the definition of postretirement benefits.	Topics 712 and 710, Compensation—General

Contractual termination benefits

Contractual termination benefits are benefits required by the terms of a plan or agreement (such as a union contract) only upon the occurrence of a specified event. These benefits are typically 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]

Other involuntary termination benefits

Other involuntary termination benefits (that are not contractual termination benefits) could be provided through an ongoing plan, which may be written or achieved through consistent past practices. If these benefits vest or accumulate, they are recognized as the employees provide services consistent with the accounting for compensated absences. Other benefits are accounted for using a loss contingency model and are recognized when it is probable the benefits will be paid and the amount can be reasonably estimated. [712-10-25-4 – 25-5]

One-time termination benefits

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. One-time termination benefits are recognized when there is a present obligation depending on the facts and circumstances. 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. Otherwise, the liability is recognized at fair value on the communication date. [420-10-25-6 – 25-9]

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



Retirement benefits: Interim remeasurements

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. A company is only required

to measure plan assets and benefit obligations as of the date of its fiscal year-end unless a significant event has occurred. An interim remeasurement is not required as a result of the changes in market prices or interest rates, unless the company's policy stipulates an interim remeasurement requirement, or a significant event such as a settlement, curtailment or plan amendment occurs. [715-30-25-5, 715-60-25-2]

In the event that a settlement, curtailment or plan amendment occurs, plan assets and the benefit obligation are remeasured as of the date the event occurs. When the event date does not coincide with a month-end, the company may remeasure plan assets and benefit obligations using the month-end closest to the date of the event. 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 event date and the month-end measurement date. As a result, and due to the current environment, determining the appropriate measurement date may be more difficult, as defaulting to the closest month-end or quarterly-end date may change the valuation significantly. [715-30-35-66 – 35-66B, 715-60-35-123A – 123B]

In addition, in this current environment companies should consider whether there is a need for an interim remeasurement when the cost of all settlements (e.g. due to lump-sum payments or other actions) during the year is greater than 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]

Sick pay and other paid time off

A company may consider extending or revising its sick leave or paid time off policies. A company accrues a liability for sick leave or paid time off when certain conditions are met, most specifically when the policy provides for sick leave or paid time off rights that vest or accumulate. Compensation for an employee's absence due to sick leave typically does not meet the liability accrual requirements because sick leave policies generally do not vest or accumulate. 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]

Furlough arrangements**

Given the current economic environment, 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 that are temporarily closed or restaurants that are offering only limited take-out services may require a limited number of employees and therefore have furloughed the other employees. Furlough arrangements are different from compensated absences or extended sick pay policies, as 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.

Furlough arrangements are usually accounted for under Topic 710 on compensated absences or Topic 712 on postemployment benefits, depending on the facts and circumstances. If a furlough arrangement provides benefits that vest or accumulate, an accrual is recognized when the furlough costs are probable and reasonably estimable under either model. However, if furlough benefits do not

vest or accumulate, which is often the case, determining when furlough-related costs should be 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. Rather, furlough-related costs are accounted for as period costs.

In determining which guidance to apply, we have identified two common areas of judgment.

Are the employees considered active during the furlough period?

Topic 712 applies to postemployment benefits provided to former or inactive employees and defines inactive employees as those that are not rendering service to their employer and who have not been terminated. It does not apply to compensated absences, which are rights of active employees to receive compensation for future absences when certain conditions are met.

Determining whether an employee is active or inactive during the furlough period may require judgment. Factors to consider in determining whether an employee is active or inactive include, but are not limited to, the following.

Indicators that the employee may be considered active during the furlough period	Indicators that the employee may be considered inactive during the furlough period
The employee is required to perform activities that benefit the employer during the furlough period to remain eligible to receive benefits.	The employee is eligible to obtain unemployment benefits while receiving furlough benefits.
The terms of the furlough arrangement require the employee to stand ready to return to work while receiving furlough benefits.	The terms of the furlough arrangement permit the employee to seek other employment at another company while receiving furlough benefits.
The employee is expected to be compensated without work for a relatively shorter period of time.	The employee is expected to be compensated without work for a relatively longer period of time.
	The communications from the company to the furloughed workforce encourage the employee to find other work or indicate that the employee's job cannot be guaranteed.

In addition, when determining whether an employee is active or inactive, some companies may consider their COVID-19 impact similar to the guidance in EITF 01-10², which addressed how companies, as a result of the terrorist attacks of September 11, 2001, recognized the costs of idled employees due to government restrictions on returning to their workplace. EITF 01-10 provided guidance that such costs should be evaluated under Topic 710 and not Topic 712, and therefore were not accrued in advance, with the assumption that those employees were deemed active. In contrast, if an employee is considered inactive under Topic 712, furlough costs would be accrued when they are probable and reasonably estimable, similar to other postemployment benefits.

For inactive employees, is the furlough liability probable and reasonably estimable?

If a company determines that furloughed employees are inactive, furlough benefit costs are accrued when they are probable and reasonably estimable. Typically, a furlough arrangement would be

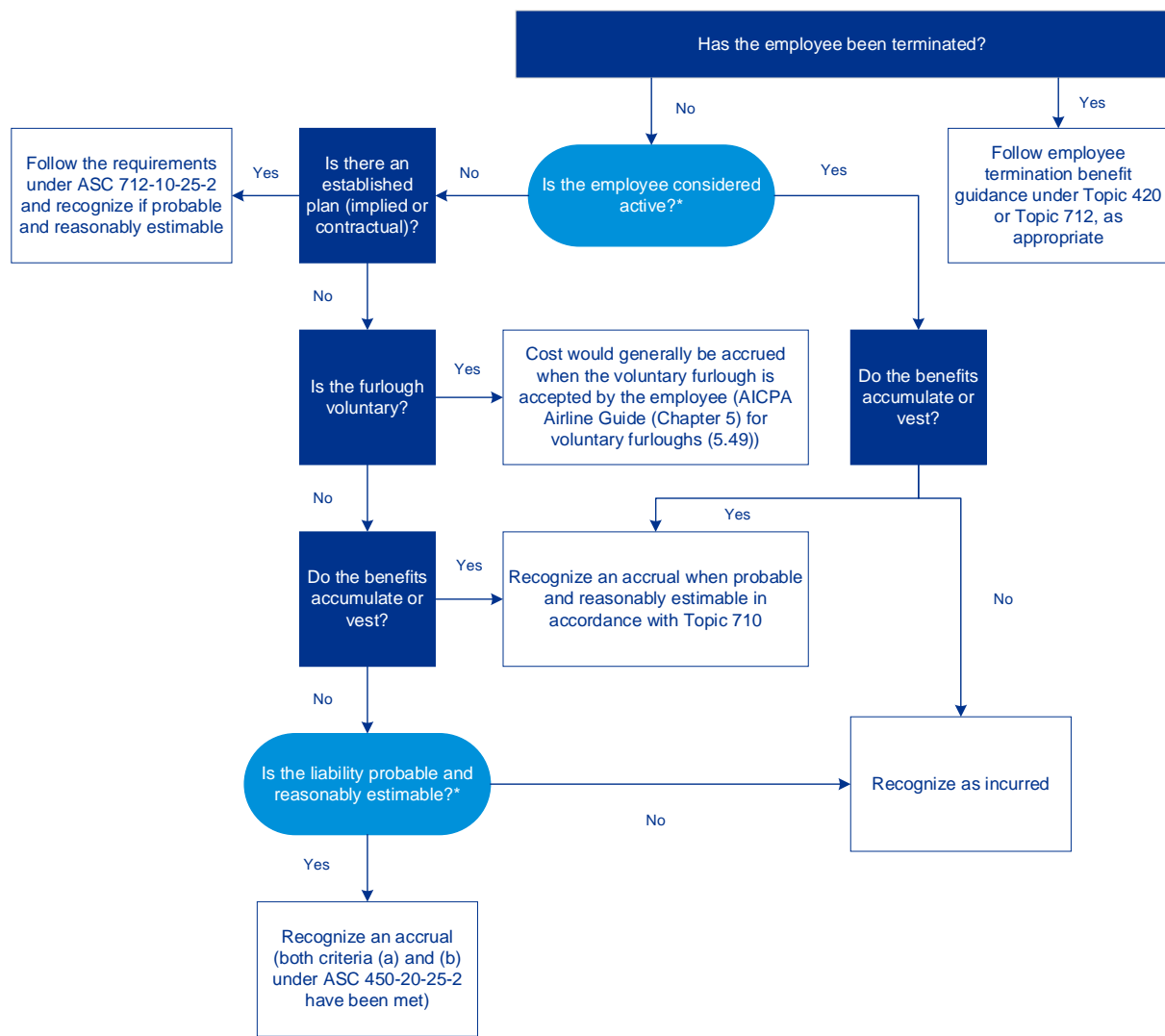
² Accounting for the impact of the terrorist attacks of September 11, 2001

considered probable if it has been communicated to the employees. However, estimating the amount of the benefits could be more challenging depending on factors such as:

- whether the furlough period is for a fixed minimum period of time or indeterminate; or
- whether it is expected that employees will voluntarily terminate during the furlough period and no longer be entitled to benefits.

If furlough costs are considered probable and reasonably estimable, an accrual for furlough costs is recognized when the event creating the obligation occurs—e.g. an announcement by the company. However, if a company concludes that the liability is not probable and reasonably estimable, additional disclosures would be expected if there is at least a reasonable possibility that a loss or an additional loss may be incurred. [450-20-50-3 - 50-6]

Below is a flowchart outlining the various Topic 710 and Topic 712 considerations in determining the appropriate recognition for furlough arrangements.





Subsequent events

The World Health Organization did not announce the coronavirus as a global health emergency until the end of January 2020, and no significant measures were taken by any governments until early 2020. Further, the effects of the COVID-19 outbreak did not have a significant impact on global markets and share prices until February 2020.

Therefore, in following the subsequent events guidance in Topic 855 in the context of the compensation matters discussed in this Hot Topic, any subsequent events related specifically to the COVID-19 outbreak would not generally be accounted for as a recognized subsequent event for companies with fiscal years ended December 31, 2019.

For calendar-year companies that have not yet reported for the year ended December 31, 2019, who conclude that a nonrecognized subsequent event has occurred, disclosures will be required. These include the nature of the event, and an estimate of its financial effect or a statement that such an estimate cannot be made. In addition, Topic 275 requires broad disclosures about risks and uncertainties, including disclosures about estimates that may change in the near future. [275-10-50, 855-10-50-2].

Determining the appropriate period in which to recognize the related COVID-19 accounting consequences may require significant judgment. For example, depending on a company's fiscal period end, it may be appropriate to recognize certain activities in the current fiscal reporting period and others in a subsequent period. In either circumstance, companies must consider the related disclosure requirements.



Evolving Information

The potential global and economic impacts of the coronavirus continue to evolve rapidly, and companies should monitor the situation. Companies are encouraged to maintain close communications with their board of directors, external auditors, legal counsel and other service providers as the circumstances progress. Stay informed at read.kpmg.us/coronavirus

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