KPMG

Accounting and Financial Reporting Update

NCREIF Fall Conference 2021

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Introductions

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Agenda

- Equity method investments
- Reference rate reform
- Simplifying accounting for income taxes
- Simplifying accounting for convertible instruments and contracts in an entity's own equity
- Derivatives and hedging
- Goodwill impairment
- The latest on ESG
- Leases

ASU 2020-01
Clarifying the Interactions between Topic 321, Topic 323 and Topic 815

A consensus of the EITF (Issue 19-A)

ASU 2020-01: Main Provisions

Issue 1: Accounting for certain equity securities upon the application or discontinuation of the equity method of accounting

Issue 2: Scope considerations for certain forward contracts and purchased options on equity securities

ASU 2020-01: Main Provisions

Summary

Issue 1

An entity should consider observable transactions that require it to either apply or discontinue the equity method when stopping or starting the measurement alternative in accordance with Topic 321 – **i.e. an observable transaction triggers remeasurement immediately before applying or upon discontinuing the equity method**.

Issue 2

An entity should **not** consider whether, upon the settlement of the forward contract or exercise of the purchased option, individually or with existing investments, the underlying securities would be accounted for under the equity method in Topic 323 or the fair value option under Topic 825.

ASU 2021-01

Reference Rate Reform (Topic 848): Scope

Reference Rate Reform – Topic 848 Scope

Background

Discounting transition: Changes in the interest rate used for margining, discounting, or contract price alignment of derivative instruments as a result of reference rate reform

Potential effects of discounting transition include:

— Changes a derivative's fair value, required variation margin payments, and interest paid/received on variation margin

— Cash compensation adjustments and basis swaps may be issued to neutralize those effects

Some central clearing parties made these changes for certain derivatives during 2020

— These types of changes were not contemplated by Topic 848, Reference rate reform

— Certain derivatives impacted by the discounting transition did not reference LIBOR or another rate that is expected to be discontinued due to reference rate reform

For a cash flow hedge, cash compensation adjustments cause a difference between the amount in AOCI and the derivative's fair value

Reference Rate Reform – Topic 848 Scope

ASU 2021-01 Summary

Extends certain optional expedients in Topic 848 to derivative instruments subject to discounting transition

— Account for a derivative modified as a result of discounting transition as a continuation of the existing contract

— Continue hedge accounting when certain critical terms of a derivative instrument used as a hedging instrument change due to modifications related to discounting transition

— Perform some effectiveness assessments in ways that disregard certain potential sources of ineffectiveness

— For cash flow hedging relationships, adjust accumulated other comprehensive income (AOCI) for the amount of cash compensation (or equivalent) exchanged using a reasonable approach

The amendments are effective for all entities immediately upon issuance

— May be elected retrospectively to eligible modifications as of any date from the beginning of the interim period that includes March 12, 2020, or prospectively to new modifications made on or after any date within the interim period that includes January 7, 2021

— Entities with derivatives impacted by discounting transition in 2020 may elect the ASU's expedients for those derivative modifications in 2020

Optional expedients are subject to Topic 848's sunset provisions

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ASU 2019-12

Simplifying the Accounting for Income Taxes

Simplification decisions

Removes the following exceptions:

1. Incremental approach for intraperiod tax allocation when there is a loss from continuing operations and income from other items
2. DTL recognition when a foreign subsidiary becomes an equity method investment
3. DTL recognition when a foreign equity method investment becomes a subsidiary
4. Calculation of income taxes in an interim period when a year-to-date loss exceeds the anticipated loss for the year

Simplification decisions, continued

Other simplifications:

1. Franchise tax partially based on income
2. Evaluation of a step up in tax basis of goodwill
3. Allocation of tax expense to entities not subject to tax
4. Effect of an enacted change in tax laws or rates
5. Improvements for employee stock ownership plans
6. Improvements for investments in qualified affordable housing projects

ASU 2020-06

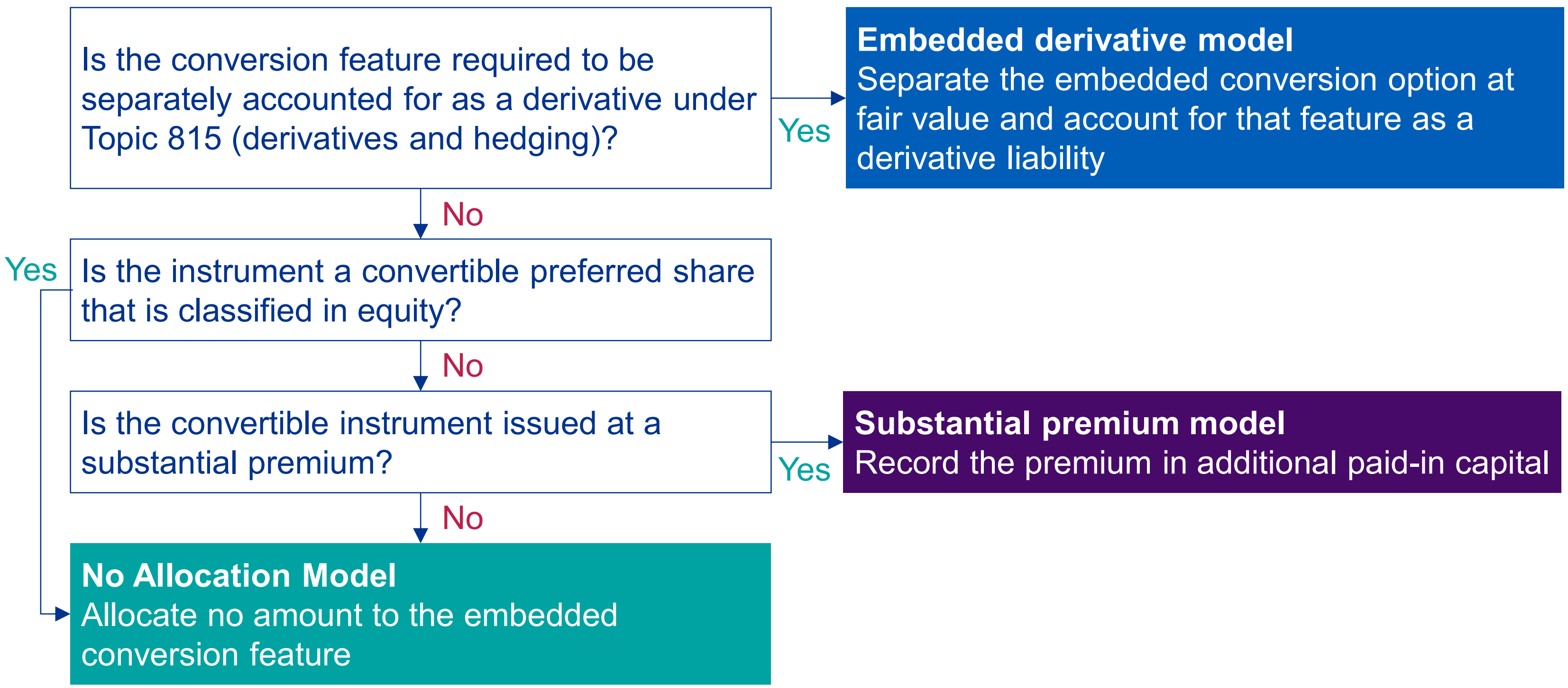
Accounting for Convertible Instruments and Contracts in an Entity's Own Equity

Key facts and impacts

Key change	Likely result
— Reduces the number of models used to account for convertible instruments — Amends the requirements for a contract (or embedded derivative) that is potentially settled in an entity's own shares to be classified in equity — Amends diluted earnings per share (EPS) calculations for convertible instruments	— More convertible instruments accounted for as a single unit with lower interest expense — Accounting for convertible instruments less complex — More contracts classified in equity (and more embedded derivatives meeting the derivative scope exception) — More dilutive EPS

Convertible debt – Summary of accounting models

The following decision tree summarizes the models and the steps for determining the appropriate model.



- These models do not apply when an entity has elected the fair value option of Subtopic 825-10.
- ASU 2020-06 eliminates the beneficial conversion feature and cash conversion models.

Requirements for equity classification (Subtopic 815-40)

- To be classified in equity (or to qualify for a derivative scope exception), Subtopic 815-40 requires a contract (or embedded feature) that is potentially settled in an entity's own shares to meet certain requirements
- ASU 2020-06 removes some of the conditions in Subtopic 815-40 that precluded equity classification and clarifies another

Removed conditions	Clarified condition
An entity is no longer required to consider whether: — settlement is permitted in unregistered shares (unless the contract explicitly requires settlement in cash if registered shares are not available); — collateral is required to be posted; and — counterparty rights rank higher than shareholder rights.	A penalty payment from the failure to make timely filings with the SEC does not preclude equity classification.

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ASU 2017-12: Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities

Changes to recognition and p

Presentation of fair value changes of hedging instruments - fair value hedge

Presentation and recognition of fair value changes of hedging instruments - cash flow hedge and net investment hedge

Amounts excluded from hedge effectiveness assessment

No separate measurement of ineffectiveness !!!

May cause significant implementation challenges!

New types of permissible hedge relationships

Non-financial items: Contractually specified components permitted for cash flow hedges

Financial instruments: Contractually specified interest rate indices permitted for cash flow hedges

Changes related to cost and complexity

Effectiveness testing

Initial prospective quantitative effectiveness assessment

Critical terms match method

Shortcut method

Changes related to fair value hedges

SIFMA permitted as a benchmark rate for fair value hedges

Benchmark interest rate component of a total coupon as a hedged risk

Partial term hedging

Prepayable hedged items

ASU 2021-03

Intangibles—Goodwill and Other (Topic 350)

Accounting Alternative for Evaluating Triggering Events

ASU 2021-03: Intangibles—Goodwill and Other — Accounting Alternative for Evaluating Triggering Events

Project Objectives:

- Provides an accounting alternative for private companies and not-for-profit entities (NFPs) to assess goodwill impairment triggering events only at reporting dates (interim or annual).

Background:

- The FASB added the accounting alternative to address private companies' concerns about the challenges of evaluating triggering events between reporting dates.
  - Received stakeholder feedback that many private companies and NFPs find it challenging to identify and evaluate triggering events and/or perform impairment tests between reporting dates.
  - Stakeholders noted most private companies and NFPs perform the goodwill triggering event analysis as part of their annual financial reporting process, which can make it more challenging to retrospectively evaluate triggering events that occur earlier in the year.
- This issue has become more apparent during the COVID-19 pandemic because of the economic uncertainty and the significant changes in facts and circumstances throughout calendar year 2020

ASU 2021-03: Intangibles—Goodwill and Other — Accounting Alternative for Evaluating Triggering Events

Key Impacts:

- Provides eligible private companies and NFPs the ability to a perform a goodwill triggering event assessment on as of their financial reporting date (interim or annual) instead of throughout the reporting period.
- Does not require an entity to elect the goodwill amortization accounting alternative to qualify for this accounting alternative.
- Allows adoption through an unconditional one-time election after the effective date without the requirement to assess the preferability of the change.
- Requires entities that elect the alternative, but later become ineligible (e.g. after an IPO), to reverse the effects of the accounting alternative. The consequences may include assessing triggering events during interim periods, without using hindsight, to determine if goodwill was impaired.
- Does not affect triggering events for impairment of other assets (e.g. long-lived assets).

The latest on ESG

ESG – SEC public consultation and next steps

— SEC disclosure-related proposals anticipated on (1) climate change, (2) human capital and (3) cybersecurity risk governance.

— SEC Chair focused on the climate-related disclosure proposals, which he expects published by the end of the year. Key points:

- 550 comment letters received > 75% supported mandatory climate disclosure rules.
- He supports mandatory disclosures that promote comparability, with a focus on decision-usefulness.
- He mentioned high numbers of companies setting emissions reduction goals, or operating in a country that has set goals, which could lead to regulatory or economic changes within those locations.
- He has asked the SEC staff to consider which data or metrics those companies might use to inform investors.
- He called out the Task Force on Climate-related Financial Disclosures (TCFD) climate disclosures as being referenced in many of the comment letters.

ESG – Intersection with international developments

- The IFRS Foundation published proposed amendments to its Constitution to accommodate the formation of a new International Sustainability Standards Board (ISSB) to set IFRS sustainability standards.

  The comment period ended in July.

- If finalized, the creation of the ISSB is expected to be announced ahead of the UN Climate Change Conference in November.
- Widespread support, including Financial Stability Board, G20 Finance Ministers and Central Bank Governors, and the International Organization of Securities Commissions.

ESG – Key takeaways

ESG reporting (particularly climate-related disclosure) is inevitable.

Formulate your ESG strategy now!

An effective strategy is led from the top, embedded in operations and involves stakeholders across the organization.

Start by understanding the concepts underpinning the TCFD.

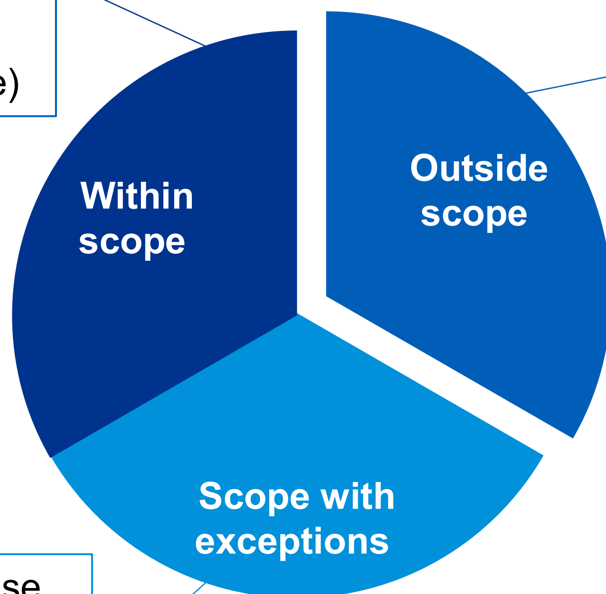
ASC Topic 842 – Leases

Title

Presenters

Scope

- Non-core assets
- Long-term leases of land
- Certain sales with repurchase rights (supplier's perspective)



Leases of/to:

- Intangible assets
- Explore for or use non-regenerative resources
- Biological assets
- Inventory
- Assets under construction

- Short-term leases (lease term ≤ 12 months)
- Underlying assets of low value (≤ $5,000, when new – IASB only)

Comparison to ASC 840

- The scope of ASC 842 is substantially aligned with ASC 840.

Certain exemptions and practical expedients

Short-term leases (lessees only)	Underlying assets of low value (IASB only)	Portfolio approach
— Leases with a lease term ≤ 12 months that do not include an option to purchase the underlying asset that the lessee is reasonably certain to exercise may apply ASC 840 operating lease accounting — If elected, the exemption is applied to all leases within that class of underlying asset — Still subject to qualitative and quantitative disclosures	— Exemption for leases of underlying assets that are individually low in value (e.g., ≤ $5,000, when new) even if material in aggregate — Leases would be accounted for off-balance sheet under IFRS, but on-balance sheet under U.S. GAAP (if not short-term)	— Aspects of ASC 842 may be applied at a portfolio level (e.g., determination of discount rate and lease term) — Must be a reasonable expectation that the portfolio approach is not materially different than application to individual leases

Separating lease and nonlease components

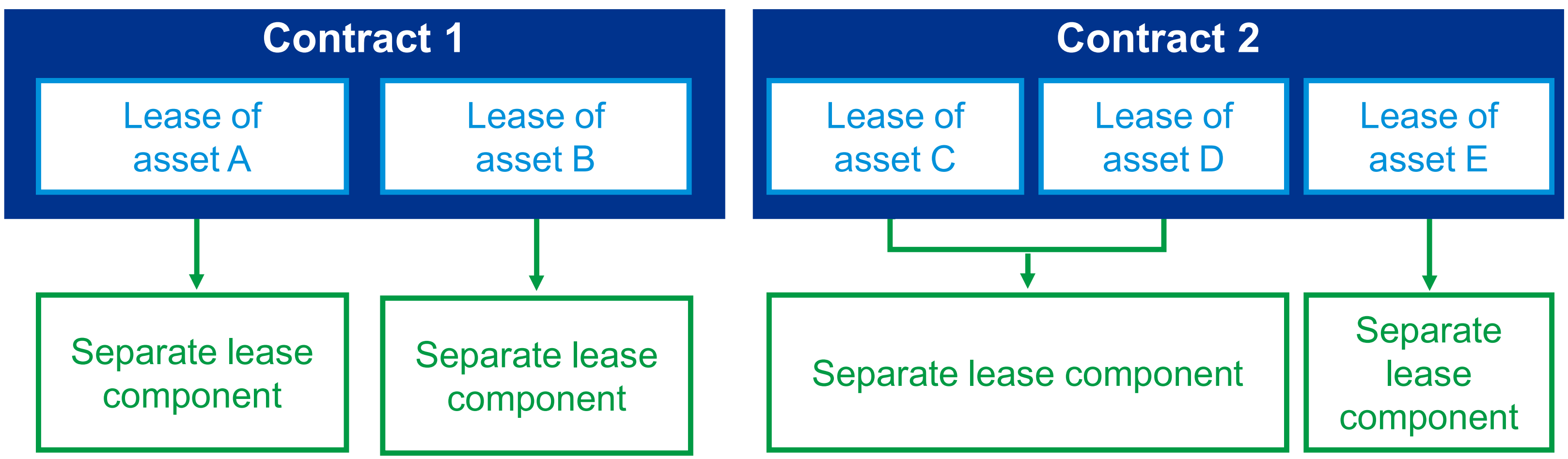
Separating components of a contract

Step 1	Identify the separate lease components. In many cases there will be a single lease component, but in some cases there will be multiple lease components.
Step 2	Identify any non-lease components – e.g., a maintenance or operating service
Step 3	Measure the 'consideration in the contract'. This calculation is different for the lessee versus the lessor.
Step 4	Separate and allocate the consideration in the contract between the lease and non-lease components. This process differs slightly for the lessee and lessor, but in both cases requires the entity to maximize the use of observable data.

Step 1 – Identify the separate lease components

— A right to use an underlying asset (i.e., a lease), or a bundle of leases, is a separate lease component if both of the following criteria are met:

- The lessee can benefit from the lease (or bundle of leases) on its own or together with other resources that are readily available to the lessee, and
- The lease (or bundle of leases) is neither highly dependent on, nor highly interrelated with, the other leases in the contract.



Separately account for land elements (even if above criteria are not met) unless accounting effect of doing so is insignificant

Step 2: Identify any non-lease components

Separating components of a contract

Contract		
Lease components	Non-lease components [1]	Not a component
Allocate consideration in the contract (Step 4)		Activities (or lessor costs) that do not transfer a good or service to the lessee [2]

(1) For example, an arrangement to lease a machine with the lessor responsible for providing machine maintenance, or to lease office space with the lessor responsible for providing common area maintenance.

- Lessees can either pay one combined amount for lease and non-lease components (gross leases) or be billed separately for the non-lease component (net leases).

(2) Examples include a lessee's reimbursement or payment of the lessor's property taxes and insurance

Step 2: Identify any non-lease components (continued)

Components of a contract = items or activities that transfer a good or service to the lessee

Example non-lease components
Providing utilities (e.g. water or electricity) to the lessee
Common area maintenance
Equipment maintenance or operation

Not a component
Delivering the leased asset
Reimbursement of lessor costs for property taxes or insurance
Residual value guarantees

Step 3: Measure the consideration in the contract (lessor)

Consideration in the contract (lessee)

Part 1

Are there any other variable payments that specifically relate to either:

The lessor's efforts to transfer one or more goods or services that are not leases?

OR

An outcome from transferring one or more goods or services that are not leases?

No → **No adjustment necessary**

Yes

Yes

Part 2

Apply variable consideration requirements in Topic 606 to measure the amount to be included in the consideration in the contract:

Step 1: Estimate the amount using the expected value or most likely amount

Step 2: Determine the portion (if any) of that amount for which it is probable that a significant revenue reversal will not subsequently occur

=

Consideration in the contract (lessor)

Step 4: Separate lease and non-lease components and allocate consideration in the contract

<table>
<tr><th></th><th>Lessee</th><th>Lessor</th></tr>
<tr><td>When there is an observable stand-alone price for each component:</td><td>Unless accounting policy elected (see below), separate and allocate based on the relative stand-alone price of components</td><td rowspan="2">Unless accounting policy elected (see below), separate and allocate following the Topic 606 transaction price allocation guidance (i.e., generally on a relative stand-alone selling price basis)</td></tr>
<tr><td>When there is not an observable stand-alone price for some or all components:</td><td>Estimate the stand-alone price, maximizing the use of observable information</td></tr>
<tr><td>Taxes and insurance on the property</td><td colspan="2">Activities (or costs of the lessor) that do not transfer a good or service to the lessee are not components of a contract and do not receive an allocation of the consideration in the contract</td></tr>
<tr><td>Accounting policy election by class of underlying asset</td><td>Account for lease and nonlease components together as a single lease component</td><td>Account for lease and nonlease components together as an operating lease component, or under Topic 606 if the nonlease component is “predominant” if specified criteria are met [(1)].</td></tr>
</table>

(1) See next slide

Lessor practical expedient summary

Policy election by class of underlying asset for lessors *not* to separate lease from non-lease components if specified criteria are met

Topic 842 (pre-ASU 2018-11): Lessors must separate lease from non-lease components and meet the relevant presentation and disclosure requirements (e.g., in Topic 842 and Topic 606, and SEC Regulation S-X)

- **ASU 2018-11 Practical expedient** - Lessor may elect not to separate lease and Topic 606 non-lease components if:
  1. Those components are co-terminus and would have the same pattern of transfer to the lessee (typically, straight-line)(1), and
  2. The lease would be an operating lease if separated.
- Lessor accounts for the combined component under Topic 606 if the "predominant" element(s) of the combined component is a non-lease component. Otherwise, the combined component is an *operating* lease component
- **Disclosures:**
  - Election of the practical expedient
  - Qualitative disclosures about the nature of out-of-scope elements combined with in-scope elements
  - Topic(s) applied (ASC 842 or ASC 606) to combined components
- Applies *from date of initial application* (which depends on transition method) for existing leases

(1) Determine non-lease component(s)' measure of progress under Topic 606

Does the new lessor practical expedient apply?

Operating office space lease and common area maintenance (CAM)

Sales-type equipment lease and related good(s) sold to the customer at lease commencement

Does the new practical expedient apply?

Operating equipment lease and operations services provided throughout the lease term

Operating equipment lease and consumables sold to the customer throughout the lease term

Transition overview

Comparative method	**Apply a modified retrospective transition approach:** — Date of initial application is the beginning of the earliest comparative period (i.e. January 1, **2017** for a calendar year-end public business entity) — Restate all comparative periods presented — No revisions to the accounting for leases that expired prior to date of initial application — ASC 842 disclosures required for all periods presented
Effective date method	**Apply a modified retrospective transition approach:** — Date of initial application is the effective date (i.e. January 1, **2019** for a calendar year-end public business entity) — No requirement to adjust comparative periods or provide comparative period disclosures — Not different than the comparative method in terms of how the transition requirements work—only different in the date of initial application — ASC 842 disclosures required only for periods post-adoption date. ASC 840 disclosures presented for comparative periods.

Transition practical expedients

Package of practical expedients[1] **(All or nothing)**	**An entity may elect not to reassess:** — Whether expired or existing contracts contain leases under the new definition of a lease; — Lease classification for expired or existing leases; and — Whether previously capitalized initial direct costs would qualify for capitalization under Topic 842.
Use of hindsight[1]	Hindsight allowed in determining the lease term, assessing the likelihood that a lessee renewal, termination or purchase option will be exercised
Land easements[1]	An entity may elect not to reassess whether land easements meet the definition of a lease if they were not accounted for as leases under Topic 840.

[1] A entity may elect any these practical expedients on its own or together with one or both of the others – i.e. an entity is not required to elect any of them because it elected another one.

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ASU 2021-05:

Leases (842): Lessors-Certain leases with variable lease payments

ASU 2021-05, Lessors-Certain leases with variable lease payments

Overview of the ASU

What? Will require lessors to classify leases with variable lease payments as operating leases if another classification (i.e. sales-type or direct financing) would result in a commencement date selling loss (Day 1 loss).

Effect?

— The lessor will neither derecognize the underlying asset nor record a Day 1 loss for such leases.

— Variable lease revenue earned and recognized over the lease term will be partially offset in income each period of the lease term by the underlying asset's depreciation.

— The FASB believes this accounting will better reflect the economics of these leases and align lessors' Topic 842 accounting for these leases with how they were generally accounted for under legacy GAAP.

ASU 2021-05, Lessors-Certain leases with variable lease payments

Transition issue: Applying ASU 2021-05 prospectively

Background: A lessor that has already adopted Topic 842 may apply the amendments prospectively to leases that commence or are modified on or after the date the entity 'first applies' the amendments. Questions have been raised about the quoted language and how an entity should apply the amendments prospectively.

KPMG interpretive guidance (forthcoming update to Leases HB > Ch. 13A/B):

— **View A:** Prospective application applies only to leases that commence or are modified on or after the ASU issuance date of July 19, 2021.

— **View B:** Prospective application can apply to all leases that commenced or were modified during any reporting period for which financial statements have not yet been issued or made available for issuance at the date the entity elects to early adopt ASU 2021-05.

ASU 2021-05, Lessors-Certain leases with variable lease payments

Effective dates

	Public business entities	All other entities
Annual periods – Fiscal years beginning after	December 15, 2021	December 15, 2021
Interim periods – Fiscal years beginning after	December 15, 2021	December 15, 2022
Early adoption permitted?	Yes, but not before adoption of Topic 842.	

Transition: The available transition approaches depend on the entity's Topic 842 adoption status as of July 19, 2021 (i.e. the issuance date of the ASU).

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