Grant Thornton

New Developments Summary

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Russia-Ukraine War

Accounting and financial reporting considerations

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Russia's invasion of Ukraine and the unprecedented economic sanctions imposed on Russia have introduced volatility into the global economy in addition to the unfolding humanitarian tragedy. While the economic effects of the Russia-Ukraine war are uncertain and evolving, entities with operations, suppliers, or customers in Russia or Ukraine will clearly be impacted. Additionally, many entities may be indirectly impacted by the war, especially in the global energy, agricultural, and capital markets, among others. This publication summarizes certain accounting and financial reporting considerations under U.S. GAAP that could apply for entities impacted by the Russia-Ukraine war.

A. Estimates and subsequent events

Entities are often required by U.S. GAAP to make assumptions about the economic consequences of disruptive biological, environmental, social, and political events when determining a variety of accounting estimates. However, forecasting the magnitude and duration of the economic impact of such events is often challenging.

Accounting estimates

Accounting estimates rely on an entity's judgmental assumptions, which must be based on a reasonable interpretation of conditions or events that are either known or knowable as of the measurement date. In other words, the assumptions used by an entity in its estimates must be both reasonable and supportable.

Determining what constitutes a "reasonable and supportable" assumption during times of economic uncertainty requires an entity to exercise professional judgment grounded in a well-controlled and supported estimation process. A well-controlled and supported estimation process includes the following steps.

Step 1:
Identify information relevant to the estimate that is reasonably known or knowable as of the measurement date. Information discovered after the measurement date, but before the financial statements are issued, may confirm such information.

Step 2:
Use the relevant information identified in Step 1 to develop a reasonable and supportable forecast of future conditions.

Step 3:
Use the reasonable and supportable forecast from Step 2 in the estimation approach to arrive at a quantitative estimate. The estimation approach used should be consistent with the relevant accounting framework.

Step 4:
Produce transparent and robust disclosures describing the key inputs and assumptions used in the entity's estimation approach.

Subsequent events

Entities may become aware of events related to the Russia-Ukraine war after the balance-sheet date, but before the financial statements are either issued or made available to be issued. Such events may include government actions, such as sanctions levied against Russia or Russian restrictions on economic activity with Western countries; disruptions to the entity's supply chains or the supply chains of their customers); or bankruptcy of customers. The guidance in ASC 855-10-25-1, *Subsequent Events,* requires

an entity to evaluate whether those events provide evidence about conditions that existed at the balance-sheet date, and to consider all information that becomes available before the financial statements are either issued or made available to be issued. To the extent that the identified events provide evidence about conditions that existed as of the balance-sheet date, an entity needs to adjust its financial statements to reflect the impact of such events. On the other hand, to the extent that events related to the Russia-Ukraine war do not provide evidence about conditions that existed at the balance-sheet date, entities may consider whether it is necessary to disclose the nature of the event and an estimate of its impact on the financial statements (or a statement indicating that such estimate cannot be made) in order to prevent the financial statements from being misleading.

Grant Thornton insight: Subsequent events and the Russia-Ukraine war

Entities need to carefully consider whether to provide disclosures about the impact of the Russia-Ukraine war on their business in the financial statements given the widespread impact of the war on the global and U.S. economies.

Entities should carefully evaluate whether events occurring after the balance-sheet date, but before the financial statements are issued or made available to be issued, provide evidence about conditions that existed as of the balance-sheet date. Although the U.S. government warned of a potential Russian invasion of Ukraine a month after Russia began amassing troops and military equipment along the Ukrainian border in November 2021, the invasion that sparked the Russia-Ukraine war did not occur until February 24, 2022, when Russian President Vladimir Putin announced a “special military operation” in Ukraine. Accordingly, we believe that in most cases, the Russia-Ukraine war constitutes a nonrecognized subsequent event for financial statements with balance-sheet dates prior to February 24, 2022.

Similarly, in most cases, the various sanctions imposed on Russia would be nonrecognized subsequent events for financial statements with a balance-sheet date prior to the announcement of the sanctions. As the scope and severity of the sanctions have changed over time, entities will need to exercise judgment to distinguish the economic impact of sanctions imposed before and those imposed after their balance-sheet date.

B. Asset impairment

The impact of the Russia-Ukraine war on entities could manifest in a variety of ways, including reduced revenue; supply chain disruptions; exposure to volatile energy, agriculture, and capital markets; increases in customers’ credit risk; the cessation of operations in foreign jurisdictions; or increased costs. These events could be indicators of asset impairment, even over a relatively short duration, which entities need to consider in preparing the financial statements.

Goodwill and other indefinite-lived intangibles impairment

The guidance in ASC 350-20-35-30, *Intangibles – Goodwill and Other: Goodwill*, requires entities to test goodwill for impairment if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount (the “triggering event”). As a result, an

entity should consider the direct and indirect impact of the Russia-Ukraine war to determine whether a triggering event has occurred by evaluating all relevant facts and circumstances, including, but not limited to, all of the factors in ASC 350-20-35-3C.

ASC 350-20-35-3C

In evaluating whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, an entity shall assess relevant events and circumstances. Examples of such events and circumstances include the following:

a. Macroeconomic conditions such as a deterioration in general economic conditions, limitations on accessing capital, fluctuations in foreign exchange rates, or other developments in equity and credit markets

b. Industry and market considerations such as a deterioration in the environment in which an entity operates, an increased competitive environment, a decline in market-dependent multiples or metrics (consider in both absolute terms and relative to peers), a change in the market for an entity's products or services, or a regulatory or political development

c. Cost factors such as increases in raw materials, labor, or other costs that have a negative effect on earnings and cash flows

d. Overall financial performance such as 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

e. Other relevant entity-specific events such as changes in management, key personnel, strategy, or customers; contemplation of bankruptcy; or litigation

f. Events affecting a reporting unit such as a change in the composition or carrying amount of its net assets, a more-likely-than-not expectation of selling or disposing of all, or a portion, of a reporting unit, the testing for recoverability of a significant asset group within a reporting unit, or recognition of a goodwill impairment loss in the financial statements of a subsidiary that is a component of the reporting unit

g. If applicable, a sustained decrease in share price (consider in both absolute terms and relative to peers).

If an entity concludes that a triggering event has occurred, it must test goodwill for impairment as of the date of the triggering event by comparing the fair value of the reporting unit to its carrying amount, unless the entity is eligible for (or has already adopted) the accounting alternative in ASU 2021-03, *Accounting Alternative for Evaluating Triggering Events* (see Snapshot 2021-06). Given the broad impact of the Russia-Ukraine war on the global economy, many entities, even those without direct exposure to Russia or Ukraine, could experience a triggering event in the current environment. Because goodwill is evaluated for impairment at the reporting unit level, if the carrying amount of a reporting unit exceeds its fair value as of the date of the triggering event, an impairment loss is recognized in an amount equal to that excess, limited to the total amount of goodwill allocated to that reporting unit.

Grant Thornton insight: Market capitalization reconciliations

For public entities, the SEC staff has expressed a view that it is prudent, even in volatile markets, to reconcile the combined fair value of an entity's reporting units to its market capitalization, which is determined by multiplying the entity's share price by the number of outstanding public shares. An entity may conclude that its current market capitalization does not reflect fair value, which is the amount at which the reporting unit as a whole could be sold in a current transaction between willing market participants. For example, the fair value of the entity as a whole may reflect a "control premium" (that is, the value derived from the ability to take advantage of synergies and other benefits as a result of controlling the entity's activities), whereas the entity's public share price would not include a control premium because a single share does not provide a market participant with control over the entity.

Management should support its assertion that all, or a portion, of the difference between an entity's market capitalization and the fair value results from a control premium. For instance, when evaluating a control premium, an entity may consider control premiums identifiable in comparable transactions or the cash flows associated with obtaining control of a reporting unit. The SEC staff has noted that they expect the strength of evidence used to support a control premium to increase as the control premium increases.

Additionally, in volatile markets, it may be reasonable to look at market capitalization over a reasonable period of time leading up to the impairment testing date. What constitutes a "reasonable" period of time is a matter of judgment, and an entity should consider relevant recent events and trends in its share price when determining a reasonable period. For instance, in the current environment, it may be challenging to support the use of share prices prior to February 24, 2022, the date when Russia invaded Ukraine. Entities need to support the range of dates used to determine market capitalization.

Finally, if an entity determines that a triggering event has occurred, it must complete its impairment test before issuing the financial statements that contain the period including the triggering event. Only disclosing that a triggering event has occurred is not sufficient.

Long-lived assets

The guidance in ASC 360-10-35-31, *Property, Plant, and Equipment*, requires entities to evaluate long-lived assets for recoverability whenever events or changes in circumstances indicate that the asset's carrying amount may not be recoverable. Entities may need to consider whether the direct and indirect impact of the Russia-Ukraine war constitutes an event that would require testing long-lived assets for recoverability, such as (a) a significant decrease in the market price of the long-lived assets, (b) a significant adverse change in the extent or manner in which long-lived assets are being used or in their physical condition, or (c) a significant adverse change in the business climate that could affect the value of the long-lived assets.

The impairment requirements in ASC 360 also apply to right-of-use assets recognized by lessees on leasing transactions accounted for under ASC 842, *Leases*.

Inventory

The Russia-Ukraine war could also affect the value of an entity's inventory. For example, entities with direct exposure to the Russian or Ukrainian markets may have inventory that cannot be feasibly

redirected to other markets. The guidance in ASC 330, *Inventory*, specifies two approaches for remeasuring inventory, depending on the cost method applied. In the first approach, inventory is remeasured using the lower of cost or net realizable value. This approach is used for all cost methods other than last-in, first-out (LIFO) or the retail method, and is widely applicable because many entities use the first-in, first-out (FIFO) or average cost methods. The second approach is the lower of cost or market method that applies only when using LIFO or the retail method.

ASC 270, *Interim Reporting,* specifies that any loss resulting from remeasuring inventory in an interim period should be recognized in the interim period in which the decline occurs. Recoveries that occur in later interim periods within the same fiscal year are recognized as gains in the interim period in which they occur, not to exceed previously recognized losses. In addition, if a decline in an interim period can be reasonably expected to be restored within the same fiscal year, the temporary decline does not need to be recognized at the interim date. However, entities may not recognize recoveries related to impairments recognized in previous fiscal years.

Production capacity issues may result from temporary plant closings or supply chain disruptions. If inventory production levels drop below normal capacity, fixed overhead costs allocations to individual units of production generally should not increase in order to capitalize most or all of the costs in inventory. Instead, the unallocated overhead costs resulting from this “excess capacity” should be expensed in the period incurred. Judgment is required to determine both the range of normal capacity based on business and industry factors and also when actual production levels fall below a reasonable range.

Entities should review firm purchase commitments with inventory suppliers for losses in the same manner as other inventory losses. In addition, if a loss is indicated, there might not be any impairment if an entity also has firm sales commitments with customers at prices that would support realizing the cost of future inventory. Often, firm purchase commitments relate to inventory similar to that already on hand. If, for example, an entity concludes that the carrying amount of the inventory on hand purchased at similar price levels is not realizable, there could also be a loss on the related firm purchase commitment.

C. Foreign currency

The Russia-Ukraine war has significantly affected currency markets. Reporting entities with foreign subsidiaries that have functional currencies other than the U.S. dollar, particularly the Ukrainian hrynvia and Russian ruble, should monitor currency markets to assess whether there are periods of time during which exchangeability is lacking between the functional currency and either the reporting currency or the currency in which a foreign currency transaction is denominated. A temporary lack of exchangeability affects the date at which an entity determines the rate used to either translate foreign subsidiary financial statements or calculate transaction gains and losses, as described in ASC 830-20-30-2, *Foreign Currency Matters: Foreign Currency Transactions*, and ASC 830-30-45-9, *Translation of Financial Statements*. As further discussed in Section D below, a lack of exchangeability that is other than temporary could call into question whether a reporting entity should continue to either consolidate a foreign subsidiary or apply the equity method of accounting to an investment in a foreign entity.

Grant Thornton insight: Changes in functional currency

Reporting entities with foreign investees should consider whether significant changes in economic facts and circumstances related to the Russia-Ukraine war warrant a change in the investee’s functional currency. For example, the war could have such a significant impact on a foreign entity’s cash flows

that the foreign entity shifts from a self-contained foreign operation to an extension of the parent company, in which case, changing the foreign subsidiary's functional currency from the local currency to the parent's reporting currency may be appropriate. It is important to note that exchange rate fluctuations in and of themselves would typically not warrant a change to a foreign entity's functional currency.

Additionally, although a reporting entity would not adjust its financial statements for exchange-rate changes that occur after the reporting date, it should disclose the effect of exchange-rate changes that occur after the reporting date if those changes significantly affect unsettled balances related to foreign currency transactions.

D. Consolidation and the equity method of accounting

Reporting entities should consider the impact of the Russia-Ukraine war when evaluating whether (a) any of their subsidiaries should be deconsolidated, or (b) any entities should be consolidated because the reporting entity has obtained control. In addition, entities should consider whether these events indicate that applying the equity method of accounting to an investment is no longer appropriate.

Consolidation

The guidance in ASC 810, *Consolidation,* requires a reporting entity to consolidate a legal entity if it has a controlling financial interest in that entity. A controlling financial interest consists of two components: (1) the ability to direct the activities that most significantly impact the economic performance of the legal entity, and (2) a variable interest in the legal entity that is potentially significant to that legal entity. Determining whether a reporting entity has a controlling financial interest is an ongoing assessment, and changes in facts and circumstances may indicate that the reporting entity has lost or gained control of an entity in which it has a variable interest.

Reporting entities should carefully assess whether a consolidated subsidiary should be deconsolidated when events and circumstances cast doubt on the reporting entity's ability to control the subsidiary. For instance, ASC 810-10-15-10 states that certain foreign exchange restrictions, controls, or other government-imposed uncertainties could be so severe as to cast significant doubt on the reporting entity's ability to control the subsidiary.

Reporting entities should also consider whether an entity that previously was not subject to the variable interest entity guidance in ASC 810-10 is now subject to that guidance due to the changes in facts and circumstances caused by the war. For example, governmental restrictions on shareholder rights might indicate that the holders of an equity investment, as a group, have lost the power to direct the activities that most significantly impact the economic performance of an entity through their equity voting rights or similar rights in the investment. If an entity in which the reporting entity holds a variable interest becomes subject to the variable interest entity guidance, the reporting entity would need to assess whether it should consolidate the variable interest entity as its primary beneficiary. Additionally, if the reporting entity concludes that it is not the primary beneficiary of the variable interest entity, the reporting entity should assess whether the disclosure requirements related to variable interests held in unconsolidated variable interest entities apply.

Equity method of accounting

Under the guidance in ASC 323, *Investments – Equity Method and Joint Ventures,* a reporting entity is required to apply the equity method of accounting to investments in both common stock and in-substance common stock of unconsolidated investees when the reporting entity has significant influence over the investee. The assessment of whether a reporting entity has significant influence over an investee is continuous, and the reporting entity should consider the effect of changes in facts and circumstances on its conclusion.

Government actions could restrict an investor's ability to exercise significant influence over an investee. For example, changes in laws and regulations might restrict an investor's voting rights; limit an investor's ability to obtain additional, or dispose of existing, investments in the investee; prevent the investor from obtaining information about the investee and its performance; or restrict the investor's rights with regard to the investee's board. The investor should consider the guidance in ASC 323-10-15-6 through 15-11 in its entirety when assessing whether the reporting entity continues to have significant influence over the investee.

E. Fair value measurement, impairment of financial assets, and hedging

Fair value

ASC 820, *Fair Value Measurement*, defines "fair value" for purposes of U.S. GAAP and provides a principles-based framework to estimate fair value. The objective of the fair value framework is to estimate the price at which an orderly transaction to sell an asset or transfer a liability would take place between market participants at the measurement date under current market conditions. Fair value is a market-based measurement, not an entity-specific measurement. Accordingly, an assertion that a current market price is not fair value because the entity would not choose to transact at the current market price is not appropriate, because an entity's intention to hold an asset or liability is not relevant to the measurement of fair value.

As a result of the Russia-Ukraine war, a variety of markets, including energy, agriculture, and the capital markets, have seen an increase in volatility, which might make it difficult for entities to assess whether transactions in those markets are "orderly" under ASC 820. However, it is not appropriate to conclude that all transactions in a given market are not orderly, because the determination of whether a transaction is orderly is made at the individual transaction level, considering the factors in ASC 820-10-35-54I. A transaction is not orderly if one or more of the market participants are compelled (not merely motivated) to transact. If an entity does not have sufficient information to conclude whether an observable transaction is orderly, it must take into account the transaction price when estimating fair value. However, the entity may place less weight on such transactions as compared to transactions that it knows to be orderly.

In addition to assessing whether observable transactions are orderly, entities need to consider other direct and indirect impacts of the Russia-Ukraine war on the fair value of its investments, including changing credit spreads, implied volatility, and market liquidity.

Impairment on investments in debt and equity securities

Financial assets that are not carried at fair value, with changes in fair value recognized in earnings, are generally subject to one of several impairment models. Entities need to carefully identify the appropriate impairment model and determine whether the Russia-Ukraine war has triggered an impairment of assets that should be recognized and, if so, the extent of the impairment.

Debt securities

Under ASC 320, *Investments – Debt and Equity Securities,* debt securities may either be classified as trading, held-to-maturity (HTM) or available-for-sale (AFS). Trading securities are measured at fair value, with changes in fair value recognized in earnings.

Prior to the adoption of ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,* which introduced the current expected credit loss (CECL) model into U.S. GAAP, both an HTM and AFS security are considered to be impaired when the fair value is less than its amortized cost basis. If an entity concludes that it intends to sell the impaired security or it is more likely than not that it will be required to sell the impaired security, then the security should be written down to its fair value through earnings. If, however, the entity does not intend to sell the security and it is not more likely than not that it will be required to sell the security, then only the amount of impairment representing the credit loss is recognized in earnings.

When evaluating whether an impairment represents an other-than-temporary impairment related to credit losses, an entity should consider all relevant factors, including asset-specific and issuer-specific credit indicators, economic factors impacting the issuer, as well as the duration and magnitude of impairment.

After the adoption of ASU 2016-13, HTM debt securities are subject to the CECL model, and an other-than-temporary impairment analysis is no longer applied. The CECL model is discussed in greater detail below. For AFS securities, an impairment model that is similar to the other-than-temporary model in legacy U.S. GAAP is applied. Under the new guidance in ASC 326-30, *Financial Instruments – Credit Losses: Available-for-Sale Debt Securities*, if an entity intends to sell an impaired security or it is more likely than not that it will be required to sell the security, then the security should be written down to its fair value through earnings. If, however, the entity does not intend to sell the security and it is not more likely than not that it will be required to sell the security, then the amount of impairment representing the credit loss is recognized in earnings, limited to the difference between the amortized cost basis and the security's fair value. Any remaining impairment is recognized in other comprehensive income.

Equity securities without a readily determinable fair value

Under ASC 321, *Investments – Equity Securities,* equity securities in investees that are not consolidated or accounted for under the equity method are generally measured at fair value, with changes in fair value recognized in earnings. However, equity investments without a readily determinable fair value may be eligible for a measurement exception in ASC 321. The measurement exception allows those investments to be measured at their cost, minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for an identical or a similar investment of the same issuer.

Equity investments that are measured using the measurement exception should be qualitatively evaluated for impairment at each reporting period. The impairment indicators include

- A significant deterioration in the earnings performance, credit rating, asset quality, or business prospects of the investee
- A significant adverse change in the regulatory, economic, or technological environment of the investee
- A significant adverse change in the general market condition of either the geographical area or the industry in which the investee operates
- Factors that raise significant concerns about the investee's ability to continue as a going concern

Given the significant economic impact of the Russia-Ukraine war, it is possible that some equity securities accounted for using the measurement alternative will exhibit qualitative indicators of impairment.

If a qualitative assessment indicates that an equity investment is impaired, the entity should measure the equity investment's fair value and record the difference between that fair value and the carrying value of the equity investment as an impairment loss in earnings.

See NDS 2016-03 for more information on accounting for equity securities under the measurement alternative.

Equity method investments

The guidance in ASC 323 requires an entity to recognize impairment losses on equity method investments when a decline in fair value below the investment's carrying amount is other than temporary. Note that "other than temporary" does not mean permanent.

An entity is required to evaluate whether such a decline in the fair value of an equity method investment is other than temporary when it becomes aware of evidence that an impairment may exist (that is, when a triggering event occurs). Such evidence includes

- The investee incurs a series of operating losses.
- The investor cannot recover the carrying amount of the investment.
- The investee cannot sustain its historical level of earnings.
- The current fair value of the investment is less than its carrying amount.
- Other investors have ceased providing support to the investee or have otherwise reduced their financial commitment to the investee.
- The investee has recognized impairment losses on its assets.

Entities with equity method investments must have a process in place to identify whether such evidence exists, and this process should consider the impact of the Russia-Ukraine war on these factors. An entity that concludes the impairment of its equity method investment is other than temporary should write the investment down to its fair value. The unit of account for evaluating impairment on an equity method investment is the investment as a whole. An equity method investor does not separately test the investee's underlying assets for impairment. However, the investor does recognize its proportionate share of any impairment recognized by the investee through the investor's recognition of equity method earnings, including adjustments for basis differences.

Grant Thornton insight: Impact of OTTI on equity method basis differences

Entities that recognize an other-than-temporary loss on equity method investments with basis differences must consider how such an impairment charge affects the investor's basis differences. ASC 323 does not provide guidance in this regard, and there may be diversity in practice. We believe one acceptable method is to allocate an other-than-temporary impairment (OTTI) to the investee's underlying assets based on their relative fair values.

In accordance with ASC 323-10-35-6, some entities may recognize equity method earnings on a lag, typically not longer than one quarter. However, an entity must evaluate an equity method investment for impairment as of the investor's balance-sheet date.

Impairment of financial assets measured at amortized cost

ASU 2016-13 introduced a new topic to the FASB Codification, ASC 326, *Credit Losses*, and the CECL model to U.S. GAAP. The amendments in ASU 2016-13 are already effective for public companies that are SEC filers (except for small reporting companies), and for all other entities are effective for fiscal years, and interim periods in those fiscal years, beginning after December 15, 2022.

Impairment prior to adoption of CECL

Prior to the adoption of ASU 2016-13, entities should apply other impairment guidance to financial instruments measured at amortized cost. For instance, debt securities classified as held-to-maturity would be subject to the other-than-temporary impairment model in ASC 320, while trade accounts receivable and loans receivable would be subject to the impairment guidance in ASC 310, *Receivables*.

Entities should consider information related to the Russia-Ukraine war that was known or knowable as of the measurement date when evaluating whether to recognize impairment.

Impairment under CECL

The CECL model under ASC 326 requires entities to recognize an allowance for credit losses on financial assets measured at amortized cost (such as debt securities classified as held-to-maturity, loans receivable, trade accounts receivable, and net investments in sales-type or direct-financing leases) as the difference between the amortized cost basis of the financial asset and the amount the entity expects to collect. The CECL model can be thought of as having five components:

- Group financial assets with similar risk characteristics into estimation pools.
- Select a method for measuring credit losses for each estimation pool.
- Determine historical losses relevant to each estimation pool.
- Adjust historical losses for current conditions and reasonable and supportable forecasts.
- Revert to historical loss experience for any portion of an asset's contractual term that extends beyond the reasonable and supportable forecast period.

See NDS 2016-10, "Measuring credit losses on financial instruments," for more information about the requirements under ASC 326.

Considering the impact of the Russia-Ukraine war on CECL

Entities estimating expected credit losses should consider information related to the Russia-Ukraine war that was known or knowable as of the measurement date. Such information may be included in the entity's forecasting assumptions used in estimating expected credit losses.

In light of the information on the Russia-Ukraine war that is known or knowable as of a measurement date, entities need to evaluate the length of their reasonable and supportable forecast period. For instance, an entity may determine that the period over which it can reasonably and supportably forecast future conditions might be shorter due to the economic instability resulting from the Russia-Ukraine war.

Additionally, entities also need to evaluate the pattern of reversion used in their estimation approach for financial assets whose contractual lives exceed the entity's reasonable and supportable forecast period. An entity should use a pattern of reversion that results in its best overall estimate of expected credit losses.

Subsequent events and CECL

ASC 855-10-55-2(e) identifies changes in estimated credit losses on receivables arising after the balance-sheet date, but before the financial statements are issued or made available to be issued, as a nonrecognized subsequent event. The SEC staff in a speech delivered at the 2018 AICPA Conference on Current SEC and PCAOB Developments further clarified how to apply this guidance in certain circumstances.

The SEC staff clarified that loan-specific information about factual conditions that existed at the balance-sheet date should be included in an entity's estimate of expected credit losses. Examples of such information include

- Servicer reports that show the effects of payment experience (including delinquencies and prepayments) that occurred on or before the measurement date
- Appraisals that show information about the fair value of loan collateral as of or before the measurement date

With regard to information related to forecast assumptions used in estimating expected credit losses, the SEC staff clarified that information received before an entity has completed an appropriate estimation process could be included in the entity's estimate of expected credit losses. That is, an entity may include information relating to forecasting assumptions used in estimating expected credit losses that is known or knowable as of the measurement date.

For instance, if, after the balance-sheet date but before the entity's financial statements are issued or made available to be issued, the U.S. government announces unemployment rates for a period that includes the measurement date, an entity may include such information in its estimation process for expected credit losses. While the unemployment rates may not have been available to the entity at the measurement date, the rates are known or knowable since the underlying economic condition (the rate of unemployment) exists and the U.S. government had access to the information.

However, an entity may not include in its estimate of expected credit losses information relating to forecasting assumptions used in estimating expected credit losses that is received before an entity has completed an appropriate estimation process if that information does not relate to the measurement date. To include such information would violate the guidance in ASC 855-10-55-2(e), which precludes recognizing changes in expected credit losses arising after the measurement date.

As noted by the SEC staff, an entity may, but is not required to, include information relating to forecasting assumptions used in estimating expected credit losses that is known or knowable as of the measurement date. Therefore, an entity must develop a clear and consistent policy for assessing whether information related to forecasting assumptions received before the completion of an appropriate expected credit loss estimation process is known or knowable as of the measurement date.

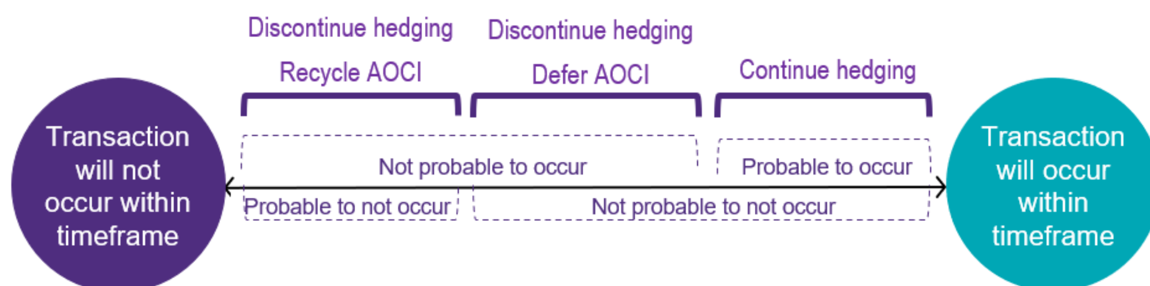
If information related to forecasting assumptions received after the entity has completed an appropriate estimation process, but before the financial statements are issued or available to be issued, indicates a weakness or deficiency in the entity's estimation process, the entity should recognize that information in its CECL estimation process.

Hedge accounting

Entities that have hedged forecasted transactions in a cash flow hedge under the guidance in ASC 815, *Derivatives and Hedging*, may need to consider whether the forecasted transactions are still probable of occurring in light of the impact of the Russia-Ukraine war.

The accounting impact of a change in an entity's assessment of the likelihood of a forecasted transaction occurring, or a change in the anticipated timing of such occurrence, depends upon whether the forecasted transaction is likely to occur within two months of the originally specified time period, as explained in the following bullets and illustration:

- If an entity determines that a hedged forecasted transaction is no longer probable of occurring, ASC 815 requires the entity to discontinue cash flow hedge accounting for that forecasted transaction prospectively.
- If an entity determines that it is not probable that the forecasted transaction either will occur or will not occur within two months of the originally specified time period, then any derivative gains or losses deferred in accumulated other comprehensive income (AOCI) prior to the change in likelihood should remain in AOCI until the forecasted transaction either impacts earnings or becomes probable of not occurring.
- If an entity determines that it is probable that the forecasted transaction will not occur by the end of the originally specified time period or within a two-month period thereafter, then the entity must immediately reclassify to earnings ("recycle") any amounts previously recognized in AOCI.



F. Leases

Lessees may be entitled to rent concessions on account of the Russia-Ukraine war. A concession may take the form of free or reduced rent for a period, the deferral of rent, or some other type of relief.

Under ASC 842 and ASC 840, both titled *Leases*, the accounting for a concession depends on whether the lessee has an enforceable right to the concession. A lease contract may provide a lessee with an enforceable right to a concession, such as a "force majeure" clause, or the laws in the jurisdiction governing the lease may create an enforceable right when a concession is legally required. Whether or not an enforceable right to a concession exists related to the Russia-Ukraine war is ultimately a legal determination.

If the concession is based on an enforceable right and no other terms of the lease have changed, then the concession is generally not accounted for as a lease modification. If the concession is not based on an enforceable right, or if other changes are made to the terms of the lease, then the concession is generally accounted for as a lease modification.

See our comprehensive guide on lease accounting, *Navigating the guidance in ASC 842*, for further information about accounting for leases under ASC 842.

G. Loan restructurings

Creditor accounting for loan restructurings

The economic impact of the Russia-Ukraine war may result in creditors and borrowers amending loan agreements. The accounting for loan restructurings depends on whether the restructuring results in a troubled debt restructuring and, if not, whether the restructuring is both commensurate with market terms and more than minor (see "Restructurings that are not TDRs" subsection).

Identifying TDRs

Under ASC 310-40, *Troubled Debt Restructurings by Creditors*, a creditor who restructures a loan must evaluate whether the restructuring constitutes a troubled debt restructuring (TDR).

According to the Codification's Master Glossary, a restructuring of a loan constitutes a TDR if the creditor, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. Under the guidance in ASC 310-40, a restructuring is a TDR if both of the following conditions are met:

- The debtor is experiencing financial difficulty.
- The creditor has granted a concession to the debtor.

If restructuring the loan does not constitute a TDR, then the creditor must evaluate whether the restructuring results in a new loan, according to the guidance in ASC 310-20, *Nonrefundable Fees and Other Costs*.

Evaluating financial difficulty

Pursuant to ASC 310-40-15-20, a creditor should consider the following conditions when evaluating whether a debtor is experiencing financial difficulty at the time of a loan restructuring:

- The debtor is currently in payment default on any of its debt, or it is probable that the debtor would be in default in the foreseeable future without the loan restructuring.
- The debtor has declared or is in the process of declaring bankruptcy.
- There is substantial doubt about the debtor's ability to continue to be a going concern.
- The debtor's securities have been, or are under threat of being, delisted.
- Based on the debtor's current capabilities, it will be unable to service all of its contractual debt payments.
- Without the loan restructuring, the debtor could not obtain other financing on terms equal to those available to non-troubled debtors.

Evaluating whether a concession is granted

Under the guidance in ASC 310-40-15-13 through 15-17, a creditor has granted a concession to a debtor if the restructured terms are not consistent with market terms available to borrowers with similar credit risk.

However, a restructuring that only results in a delay in payment that is "insignificant," as defined in ASC 310-40-15-17, is not a concession.

Restructurings that are not TDRs

An entity should apply the guidance in ASC 310-20-35-9 through 35-12 to evaluate whether a restructured loan that is not a TDR should be accounted for as either (a) a new loan, or (b) a continuation of the original loan.

A restructured loan is accounted for as a new loan if both of the following conditions are met:

- The new loan's effective yield (including any related premiums or discounts) is at least equal to the market yield for similar borrowers.
- The restructurings are more than "minor."

Under the guidance in ASC 310-20-35-11, a restructuring is more than "minor" if the present value of the cash flows under the restructured terms is at least 10 percent different from the present value of the remaining cash flows under the terms of the original instrument. If the present value of the cash flows is not more than 10 percent different from the present value of the remaining cash flows under the terms of the original instrument, then a creditor must consider other relevant considerations surrounding the restructuring to determine whether the restructuring is more than minor.

If a restructured loan is considered a new loan, any unamortized net fees or costs, as well as any prepayment penalties from the original loan, should be recognized in interest income when the new loan is granted.

If the restructured loan is not accounted for as a new loan, it is accounted for as a continuation of the original loan. For these restructured loans, an entity must continue to amortize the unamortized net fees or costs from the original loan. Any prepayment penalties associated with the original loan must also be deferred and amortized into interest income with the net deferred fees or costs. The investment in the new loan consists of the remaining net investment in the original loan, any additional amounts loaned under the restructuring, any fees received, and direct loan origination costs associated with the refinancing or restructuring.

Interest income recognition

During the April 8, 2020 FASB meeting, the FASB staff provided feedback on a technical inquiry regarding the recognition of interest income on a restructured loan that provided a "loan payment holiday" of six months and increased the term of the loan by six months. In the fact pattern discussed by the FASB staff, the restructured loan did not accrue interest during the payment holiday and could be prepaid by the borrower by paying the unpaid principal balance plus accrued interest. The restructured loan was not considered a TDR and was accounted for as a continuation of the original loan, and not as a new loan, in accordance with the guidance in ASC 310-20.

The FASB staff said they believe that a creditor may elect to either (a) recognize interest income in accordance with the contractual terms by suspending the recognition of interest income during the payment holiday period and resuming interest recognition when the payment holiday ends, or (b) determine a new effective interest rate that equates the revised contractual cash flows with the net carrying amount of the loan at the restructuring date in accordance with ASC 310-20-35-9 through 35-12. If an entity elects to apply the second approach and recognize interest during the payment holiday, the entity must still consider whether it has concerns about the realization of loan principal or interest. If such concerns exist, the entity should consider whether the recognition of interest income approach is appropriate.

Borrower accounting for loan restructurings

Entities significantly impacted by the Russia-Ukraine war may request accommodations from their lenders, including temporary payment deferrals, modifications to or waivers of violations of debt covenants, or changes to other terms of their debt agreements. Such accommodations are debt modifications and should be carefully evaluated to determine the appropriate accounting treatment.

When evaluating the accounting for modifying a liability, an entity should first consider whether the modification is a TDR. ASC 470-60, *Debt: Troubled Debt Restructurings by Debtors*, specifies that a restructuring is a TDR if two conditions are met:

- The borrower is experiencing financial difficulty.
- The lender grants a concession.

A lender "grants a concession" if the borrower's effective interest rate on the restructured debt is less than the effective interest rate of the debt immediately before the restructuring. If the restructuring results in a TDR, the borrower should perform the following steps:

- Determine the contractual cash flows of the restructured debt.
- If the total cash flows on the restructured debt are less than the carrying amount of the debt, reduce the carrying amount of the debt to the total contractual cash flows and recognize the reduction in the carrying amount of the debt as a gain on debt extinguishment.
- If the total cash flows on the restructured debt are greater than the carrying amount of the debt, determine a new effective interest rate that equates the total contractual cash flows to the carrying amount of the debt.

If the restructuring is not a TDR, then entities should consider the modification and extinguishment guidance in ASC 470-50, *Modifications and Extinguishments*. Generally, a liability associated with term debt is considered extinguished if the present value of the cash flows on the restructured debt differs by 10 percent or more from the present value of the cash flows on the original debt, with each set of cash flows discounted using the effective borrowing rate associated with the original debt. If the restructuring does not result in an extinguishment of the original debt, then the entity should determine a new effective borrowing rate on the restructured debt and apply that new rate prospectively.

H. Unusual items

Entities whose operations are directly affected by the Russia-Ukraine war should consider whether these events require application of the guidance in ASC 220-20, *Income Statement – Unusual or Infrequently Occurring Items*. If material events or transactions are marked by an "unusual nature" or an "infrequency

of occurrence," as defined, ASC 220-20 requires entities to either report them as a separate component of income from continuing operations or to disclose them in the notes to the financial statements.

Unusual nature: The underlying event or transaction should possess a high degree of abnormality and be of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity, taking into account the environment in which the entity operates (see paragraph 220-20-60-1).

Infrequency of Occurrence: The underlying event or transaction should be of a type that would not reasonably be expected to recur in the foreseeable future, taking into account the environment in which the entity operates (see paragraph 220-20-60-1).

Determining whether the war and related events, such as the imposition of economic sanctions, satisfy the criteria in ASC 220-20 may require significant judgment. If a reporting entity determines that an event meets either the "unusual nature" or "infrequency of occurrence" definition, then the financial effects of the event should either be a separate component of income from continuing operations presented in the statement of comprehensive income or disclosed in the notes to the financial statements. However, such amounts should not be presented net of tax, nor should an entity present the earnings-per-share effects of those items on the face of the statement of comprehensive income.

I. Exit or disposal activities

Entities may sell or dispose of various assets or a subsidiary in response to the Russia-Ukraine war, or they may restructure the entity. Entities may make these decisions independently or in order to comply with various government sanctions imposed by the United States on Russia and other countries participating in the invasion of Ukraine.

The guidance in ASC 420, *Exit or Disposal Cost Obligations*, should be followed in these circumstances. Events that may constitute an exit or disposal activity under ASC 420 include

- One-time termination benefits to current employees that are involuntarily terminated under the terms of a benefit arrangement that is not an ongoing benefit arrangement (or plan) or an individual deferred compensation plan
- Costs to consolidate facilities or relocate employees
- Costs associated with a disposal activity
- Costs associated with an exit activity, including exit activities related to a newly acquired business combination or an acquisition by a not-for-profit entity

A liability for the costs associated with these exit or disposal activities should be recognized at fair value in the period the liability is incurred. ASC 420 specifies that the costs and liability associated with one-time termination benefits should be recognized either on the "communication date" or, if future services are required before termination, over the service period. When closing a facility or relocating employees, however, a liability is not recorded until costs are incurred.

For entities that have adopted the new leasing guidance in ASC 842, the guidance in ASC 420 excludes costs to terminate a contract that is a lease. Instead, when an entity ceases to use a leased asset that is accounted for under ASC 842, the entity should follow the impairment guidance for right-of-use assets under ASC 360.

J. Insurance recoveries

Entities may be entitled to reimbursement for losses under various types of insurance policies as a result of the Russia-Ukraine war. Generally, probable insurance recoveries are recognized in advance of their receipt only to the extent of the losses previously recognized, while business interruption insurance on lost revenue is generally not recognized until received.

Refer to our publication, "Accounting considerations for insurance recoveries," for further discussion.

K. Revenue recognition

Variable consideration

The Russia-Ukraine war may impact estimates of variable consideration in contracts with customers. Under ASC 606, *Revenue from Contracts with Customers*, entities with customer contracts that include variable consideration (for example, rebates, discounts, or price concessions) are required to estimate the amount of consideration to which they will be entitled in exchange for transferring promised goods or services. Entities should include variable consideration in the contract transaction price only to the extent that it is probable that a significant reversal of cumulative revenue recognized will not occur when any related uncertainties are resolved. Variable consideration that is not included in the transaction price at contract inception (known as "constrained" revenue) is subsequently included when either (a) it becomes probable that a significant reversal will not occur, or (b) the uncertainty related to the variable consideration is resolved.

Entities that enter into contracts with variable consideration must update their estimates of variable consideration over the life of the contract based on facts and circumstances that are known or knowable at each reporting date. As a result, an entity may need to consider the impact of the Russia-Ukraine war on its estimate of variable consideration.

Modifications

Economic uncertainties that have resulted from the Russia-Ukraine war may lead many vendors and customers to modify existing contracts. When there is a change in the scope, price, or both in a contract and the change is enforceable, a contract modification exists, and modification accounting under ASC 606 should be applied.

Collectibility

The economic volatility stemming from the Russia-Ukraine war may impact an entity's ability to collect amounts resulting from contracts with customers. Entities may need to consider changes in collectibility with regard to existing account receivable balances.

In addition to evaluating credit losses, entities also need to reassess whether, due to changes in collectibility, a contract continues to exist for accounting purposes for the remaining goods or services to be provided under the contract. The probability of collection is one of the criteria in Step 1 for determining whether a contract exists for accounting purposes in ASC 606. Once a contract meets the Step 1 criteria, an entity is precluded from reassessing whether it continues to pass Step 1, unless there is an indication

of significant changes in facts and circumstances. When those significant changes occur, an entity should reassess collectibility in the context of future consideration for the remaining goods or services under the contract. If it is no longer probable that the entity will collect substantially all of this future consideration, ASC 606 generally requires the entity to stop recognizing further revenue and provides guidance on how to continue to assess Step 1 until either the criteria in Step 1 are subsequently met or the contract is terminated.

For new contracts, entities should consider the effects of the Russia-Ukraine war on collectibility. In the current business environment, the probability of collection of substantially all of the consideration might be less straightforward. A contract would not exist under Step 1 if collectibility is not probable.

Estimates in new contracts

In addition to reassessing ASC 606 estimates related to existing contracts, entities should similarly consider the impact of the Russia-Ukraine war on estimates involved with accounting for new contracts with customers being executed during this time of uncertainty and volatility. An entity's historical judgments and estimates may be impacted, including collectibility, stand-alone selling prices, potential price concessions, contract assets, and product returns, among other things.

Costs to obtain and fulfill a contract

Costs to obtain and costs to fulfill contracts are capitalized under the guidance in ASC 340-40, *Other Assets and Deferred Costs: Contracts with Customers*. Under that guidance, an entity should recognize an impairment loss in earnings if the consideration that the entity either expects to receive in the future or has received but has not yet recognized as revenue, minus the costs directly related to providing goods or services that have not yet been expensed, is less than the carrying amount of the capitalized costs. Entities should consider whether changes in estimates of either the amount of consideration the entity expects to receive or the costs directly related to providing the goods or services as a result of the Russia-Ukraine war indicate that the carrying amount of costs to obtain and fulfill contracts is impaired. However, prior to assessing whether capitalized costs to obtain and fulfill contracts are impaired, an entity should first perform an impairment assessment on assets related to the contract that are outside the scope of ASC 340 (for example, inventory accounted for under ASC 330). Next, an entity should apply the impairment guidance to assets related to the contract that are recognized in accordance with ASC 340.

Capitalized costs to obtain and fulfill contracts may also be considered for impairment under other accounting guidance. After applying the impairment guidance in ASC 340-40, an entity includes the resulting carrying amount of the asset in the carrying amount of the asset group or reporting unit to which that asset belongs for purposes of applying the impairment guidance in ASC 360 for long-lived assets or in ASC 350 for goodwill.

Finally, for any remaining amount of capitalized costs to obtain and fulfill a contract, an entity should consider whether the manner of amortization should be updated.

Contract assets

Contract assets arising in situations where an entity has met the criteria to recognize revenue under ASC 606, but the entity's right to consideration is conditioned on something other than the passage of time, are subject to the guidance on credit losses in either ASC 310 or ASC 326, as applicable.

Disclosures

ASC 606 requires disclosures about changes in judgments and about other matters, such as the impairment of contract assets. Therefore, the impact of the Russia-Ukraine war may trigger the need for incremental disclosures, including the methods, inputs, and assumptions used for estimating variable consideration and constrained amounts; the timing of satisfying performance obligations; and other aspects of revenue recognition.

See our comprehensive guide on revenue recognition, *Revenue from Contracts with Customers: Navigating the guidance in ASC 606 and ASC 340-40*, for further information.

L. Disclosures

Entities affected by the Russia-Ukraine war need to consider the implications on the disclosures included in their financial statements. The degree of disclosure required in an affected entity's financial reporting depends on the nature, duration, and extent of the impact of the Russia-Ukraine war on the entity. Entities need to continue monitoring developments related to the war and to evaluate the appropriateness of their disclosures in light of changes caused by the war.

Contingent losses

The guidance on contingencies in ASC 450-20-25-2, *Contingencies: Loss Contingencies*, requires an entity to recognize a contingent loss if (a) it is probable that the liability has been incurred as of the balance-sheet date, and (b) the amount of the loss is reasonably estimable (as either a point estimate or a range of loss). Additionally, ASC 450-20-50-2 requires that contingent losses that are at least reasonably possible should be disclosed, even if the amount of the loss is not reasonably estimable.

Entities need to consider whether events related to the Russia-Ukraine war indicate that it is reasonably possible they have incurred a contingent loss and to make disclosures as appropriate.

Going concern

The guidance in ASC 205-40, *Presentation and Disclosure: Going Concern*, requires entities to evaluate their ability to continue as a going concern within one year after the financial statements are either issued or made available to be issued. An entity that concludes that there is substantial doubt about its ability to continue as a going concern or that its plans alleviate that doubt must provide disclosures to that effect.

An entity may need to re-evaluate its analysis of its ability to continue as a going concern for one year after the date of the financial statements (including considering management's plans to alleviate any substantial doubt, if any) as a result of the Russia-Ukraine war.

Risks and uncertainties

Under ASC 275, *Risks and Uncertainties*, entities are required to make qualitative disclosures about risks and uncertainties that could significantly impact the amounts reported in the financial statements in the near term (that is, within one year from the date of the financial statements). Entities may need to evaluate whether it is necessary to include specific disclosures related to risks and uncertainties introduced by the Russia-Ukraine war, including disclosures for significant accounting estimates and vulnerabilities due to concentrations in vendors or customers.

MD&A and Risk Factors

In addition to disclosures in their financial statements, entities may need to provide additional disclosures about the impact of the Russia-Ukraine war in their SEC filings under Regulation S-X in both Management's Discussion and Analysis (MD&A) and Risk Factors.

MD&A

Entities need to provide a clear and understandable discussion of known trends or uncertainties that either have or are expected to have a material impact on revenue, income, operations, financial condition, or liquidity in MD&A.

Risk Factors

Entities also need to disclose significant risks that could impact their results and the securities they have issued. Entities should consider whether it is necessary to include specific risk factors related to the Russia-Ukraine war and their possible impact on their business.

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For additional information on topics covered in this document, contact your Grant Thornton LLP professional.

Contacts

Ryan Brady
Partner
Accounting Principles Group
T +1 312 602 8741
E ryan.brady@us.gt.com

Graham Dyer
Partner
Accounting Principles Group
T +1 312.602.8107
E Graham.Dyer@us.gt.com