

# Technical Line

## Accounting and reporting considerations for the effects of the coronavirus outbreak

Revised 4 June 2020

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### What you need to know

- ▶ Companies need to continue to consider the accounting and disclosure implications of the coronavirus (COVID-19) pandemic and its economic effects.
- ▶ Affected SEC registrants may need to make additional disclosures.
- ▶ Business disruptions may indicate a change in circumstances that could result in asset impairments or require a change in accounting estimates.
- ▶ Companies may experience delays in obtaining financial information required for preparing consolidated financial statements, which may inhibit timely reporting.
- ▶ Companies that received relief from stimulus programs created by the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) or from provisions of the law that affect income taxes and other matters need to consider the financial reporting implications.
- ▶ The accounting and disclosure implications may range from narrow to extensive, depending on the circumstances.

### Overview

Companies need to consider whether they face any accounting or disclosure implications resulting from the COVID-19 pandemic and its economic fallout. In the US, state and local officials have ordered many companies to limit or suspend operations, and many other countries have instituted similar restrictions. Travel has also been severely restricted both domestically and internationally.

The result was a decline in economic activity in a number of industries and a decline in the stock prices of many companies around the world. Government stimulus measures in response to the economic fallout have been implemented or are being considered around the world.

In the US, President Donald Trump signed the CARES Act into law on 27 March 2020. This publication addresses the accounting and reporting considerations for certain relief and stimulus measures in the CARES Act, including key income tax provisions. It also provides broad accounting considerations for government assistance programs around the world. Readers may also want to review our separate To the Point publication, [\*\*Relief provided by the CARES Act will affect accounting and financial reporting.\*\*](#)

While the extent and duration of the economic fallout from the COVID-19 pandemic remains unclear, affected companies need to consider factors such as (1) whether operational disruptions indicate a change in circumstances that might trigger asset impairments; (2) whether they need to revisit accounting estimates, such as the amount of variable consideration they expect to be entitled to; and (3) what the effect might be on hedging relationships, compensation arrangements, leases and income taxes. Entities also need to consider how the COVID-19 pandemic may affect internal control over financial reporting (ICFR). Securities and Exchange Commission (SEC) filers also should consider whether their disclosures in management's discussion and analysis (MD&A) and their risk factor disclosures about the current and potential effects of the COVID-19 pandemic are appropriate.

This publication updates the Technical Line we issued on 12 March 2020 and revised on 31 March 2020 to address accounting and financial reporting considerations for affected companies. It also discusses disclosure considerations, including considerations for filings with the SEC. New sections and sections that have been updated to reflect developments since the original publication are labeled.

For more information about the topics discussed throughout this Technical Line, refer to a list of our other publications in the Appendix. In addition, refer to our sector specific publications, [\*\*Accounting considerations related to recent declines in oil and gas prices\*\*](#) and [\*\*Lessee accounting considerations for retailers in the current environment\*\*](#), for more information about the impact of COVID-19 on the oil and gas and retail industries.

## Accounting considerations

### Asset impairments

Many companies have experienced a decline in revenues and in some instances have been forced to close temporarily. The effects on businesses have been pervasive, and it is uncertain how long the effects will persist and how widespread the effects will be. Further, the uncertainty and related factors have resulted in significant volatility in the financial markets. In addition, some manufacturers have said they expect supply chain disruptions and temporary business closures in affected regions to limit their ability to meet demand for their products. Companies may also see their cost structures change if they have to replace suppliers or move operations to another region.

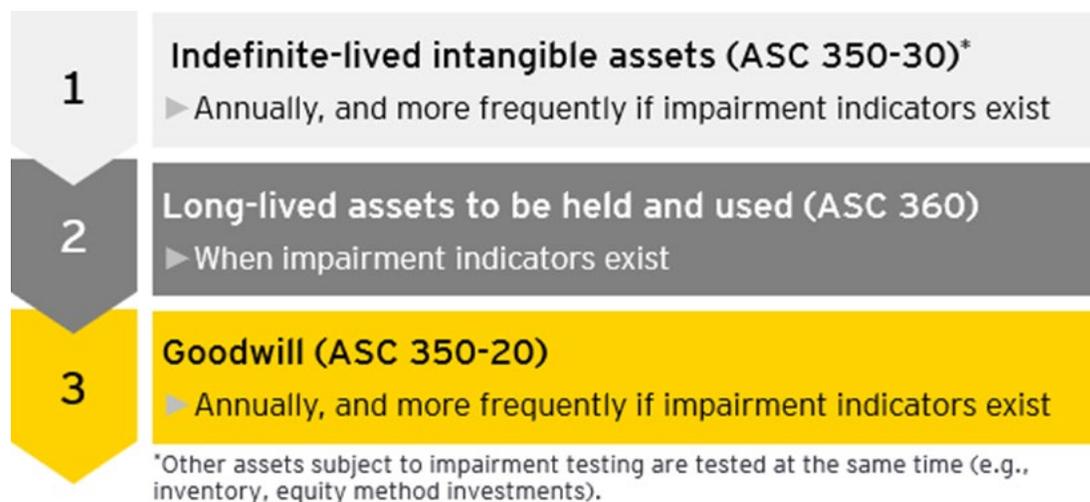
These factors could be indicators of impairment, depending on the significance and duration of the disruption. While short-term disruptions may not indicate an impairment, the effects of a prolonged suspension of activities may cause asset impairments.

If a company determines that the economic effects of the COVID-19 pandemic are impairment indicators that require it to perform impairment tests, the company needs to make sure it performs those tests in the appropriate order. Indefinite-lived intangible assets are tested first

It is challenging to predict the effects on companies because it isn't clear how long the economic fallout from the pandemic will last.

for impairment in accordance with Accounting Standards Codification (ASC) 350, *Intangibles – Goodwill and Other*. Groups of long-lived assets are then tested for impairment in accordance with ASC 360, *Property, Plant, and Equipment*. Goodwill is tested for impairment last, and those tests are performed at the reporting unit level.

The graphic below shows the order in which assets generally need to be tested for impairment.



Long-lived assets that are held and used include land, buildings, machinery and finite-lived intangible assets that do not meet the held-for-sale criteria. When a disposal group is held for sale, the order of impairment testing differs. Guidance on how to test long-lived assets to be held and used, and disposal groups that are held for sale, for impairment under ASC 360 can be found in our Financial reporting developments (FRD) publication, [\*Impairment or disposal of long-lived assets\*](#).

#### ***Inventory (updated 31 March 2020)***

##### *Net realizability*

If there is a decline in the net realizable value or utility of inventory, ASC 330, *Inventory*, requires the decline to be recognized as a charge in the period in which it occurs. A loss may result from damage, contamination, physical deterioration, obsolescence, changes in price levels or other causes.

Inventory measured using any method (e.g., first-in, first-out (FIFO), average cost) other than the last-in, first-out (LIFO) method or the retail inventory method is measured at the lower of cost or net realizable value. Inventory measured using the LIFO or the retail inventory method is measured at the lower of cost or market.

Companies whose supply chains have been disrupted or whose sales have fallen because of the current market conditions should evaluate whether they need to adjust the carrying value of their inventory. Seasonal inventories, perishable products and products with shorter shelf lives would be most exposed to the risk of loss.

For interim reporting periods, entities should also consider the requirements in ASC 270, *Interim Reporting*, for accounting for a decline in the net realizable value or utility of inventories. Inventory losses due to the application of the subsequent measurement guidance in ASC 330 should not be deferred beyond the interim period in which the decline occurs, unless the decline can reasonably be expected to be restored within the same fiscal year. If inventory is written down as of an interim date, the recovery of these losses in later interim periods of the same fiscal year should be reflected as a gain in the later interim period.

However, the amount of gains recorded by an entity should not exceed the previously recognized losses. The gain should be recorded in the same line item in the income statement as the inventory write-down.

Temporary declines in the market value of inventory measured using the LIFO or retail inventory methods, or the net realizable value of all other inventory that can reasonably be expected to be restored by the end of the fiscal year, need not be recognized at the interim date since no loss is expected to be incurred in the fiscal year.

Refer to our SEC Financial Reporting Series, [\*2020 SEC quarterly reports-Form 10-Q\*](#), for additional information.

#### *Firm purchase commitments for inventory (added 31 March 2020)*

Firm commitments for the future purchase of inventory items should be included in the net realizability analysis, just like on-hand inventory, and the net loss on firm, noncancelable or unhedged purchase commitments should be measured in the same manner as inventory.

If the amounts to be realized from the disposition of the inventory underlying the purchase commitments are adequately protected by firm sales contracts or there are other circumstances that may reasonably assure continuing sales without price declines, the commitments may not be impaired. If an impairment is recognized for a firm purchase commitment of inventory, the cost basis of the inventory covered by the commitment is reduced by the amount of the impairment when the entity acquires that inventory.

#### *Changes in manufacturing levels and excess capacity*

Unplanned work stoppages, labor or material shortages, or production bottlenecks could cause production levels to drop below normal capacity levels. If this happens, a company will need to consider the effects on its inventory costing. The amount of fixed overhead allocated to each unit of production is not increased when production is abnormally low, and the costs associated with underutilized capacity (known as "excess capacity costs") are expensed in the period they are incurred without adjusting overhead absorption rates.

Companies will need to use judgment to determine when production is lower than normal capacity. The range of normal capacity can vary based on business and industry-specific factors.

#### *Goodwill and other indefinite-lived intangible assets (updated 31 March 2020)*

Goodwill and indefinite-lived intangible assets are tested for impairment at least annually and more frequently if events or changes in circumstances indicate that it is more likely than not that the asset is impaired. ASC 350, *Intangibles – Goodwill and Other*, provides examples of events and circumstances that should be considered in evaluating whether an interim impairment test is required for both goodwill and indefinite-lived intangible assets. To determine whether an interim impairment test is required, companies will need to consider the potential effects of the current economic conditions on the fair value measurement of their reporting units and indefinite-lived intangible assets. The current economic environment, including the significant declines in many companies' share prices, market volatility and the disruptions to many companies' operations, may indicate that an interim impairment test is required

Refer to our Technical Line, [\*Accounting for impairment of goodwill and indefinite-lived intangible assets due to the coronavirus\*](#), for more information, including other examples of events and changes in circumstances that a company may consider when evaluating whether an interim impairment test may be required under ASC 350.

Refer to our FRD, [\*Intangibles – goodwill and other\*](#), for more guidance.

### ***Long-lived assets***

Companies affected by the COVID-19 pandemic may need to determine whether there are indicators of impairment for their long-lived assets. Long-lived assets to be held and used (including right-of-use assets under ASC 842, *Leases*) are tested for impairment when factors are present that indicate that the recorded value of a long-lived asset or asset group may not be recoverable. The impairment evaluation of long-lived assets to be held and used involves three steps:

- ▶ Step 1: determining whether an indicator of impairment exists and, if one is present, proceeding to Step 2 – Examples of indicators of impairment include a significant decrease in market value, an adverse change in how a long-lived asset or asset group is planned to be used, or a significant change in the business environment that could adversely affect the value of the long-lived asset or asset group.
- ▶ Step 2: testing the long-lived asset or asset group for recoverability – Estimated undiscounted cash flows for a long-lived asset or asset group being evaluated for recoverability are compared with the carrying amount of that asset or asset group. If the estimated undiscounted cash flows exceed the carrying amount of the long-lived asset or asset group, the carrying amount of the long-lived asset or asset group is considered recoverable and an impairment would not be recorded. If the carrying amount of the long-lived asset or asset group exceeds the estimated undiscounted cash flows (i.e., the carrying amount of the long-lived asset or asset group is not recoverable), the entity would proceed to Step 3.
- ▶ Step 3: measuring the amount of the impairment – An entity that determines that the carrying amount is not recoverable is required to determine the fair value of the long-lived asset or asset group and recognize an impairment loss if the carrying amount of the long-lived asset or asset group exceeds its fair value.

Companies may need to revisit their estimates of service periods for long-lived assets if they take steps such as relocating factories or business units to other locations. Changes in the planned service period could result in changes to the depreciable lives of those long-lived assets.

Refer to our FRD, [\*\*\*Impairment or disposal of long-lived assets\*\*\*](#), for details on accounting for impairments of long-lived assets.

### ***Equity method investments (updated 31 March 2020)***

Equity method investments (including investments in joint ventures) are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the investment might not be recoverable in accordance with ASC 323, *Investments – Equity Method and Joint Ventures*. Evidence that could indicate the carrying amount of the investment might not be recoverable includes:

- ▶ The investor does not have the ability to recover the carrying amount of the investment.
- ▶ The investee cannot sustain earnings.
- ▶ The current fair value of the investment is less than the carrying amount.
- ▶ Other investors have ceased providing support or reduced their financial commitment to the investee.

Entities should consider whether current conditions and the current economic environment represent changes in circumstances that require an impairment assessment for equity method investments.

If there has been a significant decline in the value of an investee, an investor would need to exercise judgment to determine whether the decline is other than temporary. This aspect of the test differs from other impairment tests, such as those for goodwill and indefinite-lived intangible assets under ASC 350, that don't require consideration of whether an impairment is temporary. When an investor has the intent and/or ability to recover the carrying amount of the investment over a long period (e.g., from cash flows from the investee) the investor still must evaluate whether that recovery will occur in the near term. If the fair value of the investment is less than its carrying amount and the investment will not recover in the near term, an other-than-temporary impairment may exist.

An impairment loss is recognized for a decrease in value of an investment that is other than a temporary decline. The investment is recorded at its fair value (i.e., the impairment is measured as the difference between its carrying amount and fair value). ASC 820, *Fair Value Measurement*, provides the authoritative guidance for measuring fair value. See the *Fair value measurement* section below for more guidance on determining fair value and the required disclosures.

Because ASC 323 does not address how an impairment charge affects an investor's basis differences (i.e., differences between the carrying amount of the investment and the investor's share of the net assets of the investee), there may be diversity in practice. An investor should determine an appropriate accounting policy for assigning impairment charges recorded for an equity method investment to the basis differences related to that equity method investment.

The investor's unit of account for evaluating impairment associated with an equity method investment is the investment as a whole. That is, an equity method investor does not separately test an investee's underlying asset(s) for impairment. Instead, an investor recognizes its portion of any impairment recognized by the investee through its application of the equity method of accounting, adjusted for basis differences. An investor also should consider whether its investment as a whole might be impaired when an investee recognizes an impairment loss.

If an other-than-temporary impairment is recorded, additional disclosures are required since the investment would be measured at fair value under ASC 820. An investor also should disclose the line item in which the impairment loss is presented in the financial statements. If an investor does not record an impairment after evaluating an equity method investment for other-than-temporary impairment, the investor should consider whether disclosing the significant judgments and estimates it used in that evaluation might be appropriate, given the requirements of ASC 275, *Risks and Uncertainties*, and the possibility of a charge in a future period.

When an investor accounts for an equity method investment on a lag, it should also disclose events that occurred between the date of the investee's financial statements that are used when applying the equity method of accounting and the date the investor's financial statements are made available for issuance, if those events materially affect the financial position or results of operations of the investee.

If an investee changes its governance structure or files for bankruptcy, an investor should evaluate the facts and circumstances to determine whether it continues to have significant influence over the equity method investee.

Refer to our FRD, [\*Equity method investments and joint ventures\*](#), for more guidance.

***Equity securities measured using the measurement alternative (after the adoption of Accounting Standards Update (ASU) 2016-01)***

For equity securities measured using the measurement alternative in ASC 321, *Investments – Equity Securities*, entities are required to perform a qualitative impairment assessment. Impairment indicators an entity needs to consider include a significant deterioration in earnings and a significant adverse change in the economic environment of the investee. If a qualitative assessment indicates that the investment is impaired, and if the investment's fair value is less than its amortized cost basis, the excess of the amortized cost basis over fair value is recognized as an impairment loss.

Refer to our FRD, ***Certain investments in debt and equity securities (after the adoption of ASU 2016-01)***, for additional information.

***Investments in debt securities (added 31 March 2020)***

Entities that hold debt securities that are not measured at fair value with changes in the fair value of the securities recognized in net income are required to assess at each reporting date whether to recognize an impairment loss.

The new credit impairment guidance in ASU 2016-13 provides separate credit loss models for held-to-maturity (HTM) and available-for-sale (AFS) debt securities in ASC 326-20, *Financial Instruments – Credit Losses – Measured at Amortized Cost*, and ASC 326-30, *Financial Instruments – Credit Losses – Available-for-Sale Debt Securities*, respectively. For HTM debt securities and certain other financial assets, entities are required to estimate expected credit losses, which generally results in earlier recognition of credit losses than under the legacy guidance. For AFS debt securities, entities are required to recognize an allowance for credit losses instead of an other-than-temporary impairment that reduces the cost basis of the investment.

This guidance is effective for public business entities that are SEC filers that are not smaller reporting companies, for fiscal years beginning after 15 December 2019, including interim periods within those fiscal years. For all other entities, the guidance is effective for fiscal years beginning after 15 December 2022, including interim periods within those fiscal years.

***Accounting for impairment of AFS and HTM securities (before the adoption of ASU 2016-13)***

Entities that have not yet adopted ASU 2016-13 recognize an impairment loss on an AFS or HTM security when the security is considered other than temporarily impaired (OTTI).

An AFS or HTM debt security is considered OTTI if its fair value is less than its amortized cost basis and (1) the entity has the intent to sell the security, (2) it is more likely than not that the entity will be required to sell the security or (3) the entity does not expect to recover the entire amortized cost of the security (i.e., a credit loss exists). ASC 320, *Investments – Debt and Equity Securities*, lists factors an investor should consider to determine whether a credit loss exists and the period over which the security is expected to recover. These factors include the length of time and the extent to which the fair value has been less than the amortized cost basis and adverse conditions related to the security (e.g., any changes to the rating of the security by a rating agency), the issuer's industry or the geographic area where the issuer operates.

There is no "bright line" or "safe harbor" in either the duration or severity of an impairment to indicate whether it is other than temporary. As declines in fair value become more severe, an entity must do more analysis and collect more objective evidence to support an assertion that an OTTI does not exist. If an entity intends to sell an impaired debt security or it is more likely than not that it will be required to sell prior to recovery of its amortized cost basis, the amortized cost basis of the security is written down to fair value and the realized loss is charged to earnings. If an entity does not intend to sell an impaired debt security and it is not more

Volatility in global markets may affect the fair value of debt and equity securities.

likely than not that it will be required to sell the security prior to recovery of the amortized cost basis, the OTTI amount representing the credit loss is recognized in net income and the amount related to all other factors is recognized in other comprehensive income. Further, OTTI write-downs of a debt security cannot be immediately reversed. Rather, any improvement in cash flows expected to be collected is recognized over the remaining life of the security as an adjustment to yield.

*Accounting for impairment of AFS and HTM securities (after the adoption of ASU 2016-13)*

Consistent with legacy GAAP, an AFS debt security is considered impaired if its fair value is less than its amortized cost basis. If an entity intends to sell an impaired AFS debt security or more likely than not will be required to sell the security before recovering its amortized cost basis, the entire impairment amount is recognized in earnings with a corresponding adjustment to the security's amortized cost basis.

An entity that does not intend to sell an impaired AFS debt security and is not more likely than not to be required to sell the security prior to recovery of its amortized cost basis must determine whether any impairment is attributable to credit-related factors. Management may not use the length of time an AFS debt security has been in an unrealized loss position as a factor, either by itself or in combination with other factors, to conclude that a credit loss does not exist, as is permitted under legacy GAAP. If any impairment is attributable to credit-related factors, an entity must measure the credit loss and recognize an allowance for credit losses along with the related charge to earnings. The amount of the allowance is limited to the difference between the security's amortized cost basis and its fair value. Further, any improvements in estimated credit losses on AFS debt securities are recognized immediately in earnings to the extent of the amount of any allowance and then prospectively as a yield adjustment.

In addition, after adopting ASU 2016-13, entities account for impairment of HTM debt securities consistently with how impairment is recognized for loans and other financing receivables. See the discussion in the following section for further discussion of this guidance.

Refer to our FRD, [\*Credit impairment under ASC 326\*](#), for additional information.

***Financing receivables and contract assets (updated 4 June 2020)***

Entities with financing receivables (e.g., loans, trade accounts receivable) and contract assets should consider the guidance in ASC 326, *Financial Instruments – Credit Losses*, or ASC 310, *Receivables*, if they haven't yet adopted the new standard, to evaluate whether and to what extent COVID-19 affects the collectibility of their receivables and contract assets.

Companies applying ASC 326 are required to consider reasonable and supportable forecasts of future economic conditions in the estimate of expected credit losses. Affected companies that apply ASC 326 will need to consider the degree to which the economic impact of the market disruption changes their forecast of future economic conditions. In particular, disruption of supply chains and changes in demand will often increase the likelihood of borrowers taking a longer time to repay amounts outstanding or the probability of borrowers being unable to repay their obligations when due. This may be particularly true for companies in industries or in geographies where the effects of COVID-19 have been more pervasive.

We note that companies are finding it challenging to estimate the economic effect of the COVID-19 pandemic because historical data may not include the effects of similar events. We also believe that, while forecasted economic conditions may not significantly affect loss estimates for short-term receivables and contract assets when the economy is stable, entities affected by the COVID-19 pandemic may need to challenge the assumptions they used to measure allowances for these assets too.

Companies are finding it challenging to estimate the economic effect of the COVID-19 pandemic because historical data may not include the effects of similar events.

ASC 326 requires companies to pool financial assets but allows them to choose which risk characteristics to use. Affected companies need to assess whether assets in pools continue to display similar risk characteristics or determine whether they need to revise their pools or perform an individual assessment of expected credit losses.

Affected companies may find it necessary to modify a borrower's payment terms (including providing a borrower with more time to pay its debt)<sup>1</sup> if the economic fallout from the COVID-19 pandemic affects the borrower's liquidity. See further discussion in the *Debt modifications and loan covenants* section below.

There are significant uncertainties about what the effects of the COVID-19 pandemic will ultimately be. Entities should consider highlighting these risks in their qualitative and quantitative disclosures about credit risk and the allowance for credit losses. They should also consider the disclosures related to the basis of inputs and assumptions and estimation techniques used, and how forward-looking information has been incorporated.

If an entity believes it is appropriate to incorporate in its expected credit loss model an input, assumption or forward-looking adjustment associated with the impact of the COVID-19 pandemic, and if the effect of this is significant or it is otherwise useful to understand the uncertainty of future cash flows, the entity should disclose such an input, assumption or forward-looking adjustment.

On 27 March 2020, the Federal Reserve, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, published an interim final ruling that provides banks with additional capital relief for credit loss allowances measured in accordance with ASC 326. Specifically, the interim final rule allows banks to add back a portion of the allowance for credit losses measured in accordance with ASC 326 to regulatory capital for up to five years. The amount entities can add back is reduced if the adoption of ASC 326 resulted in a decrease in the allowance for credit losses.

Refer to our FRD publications, [\*Credit impairment under ASC 326\*](#) and [\*Credit impairment for short-term receivables under ASC 326\*](#), for more information on measuring credit impairment after the adoption of ASC 326.

#### ***Guarantees in scope of ASC 326 (added 4 June 2020)***

Entities that issue guarantees in the scope of ASC 460 (e.g., guarantees of lease obligations, customer financing arrangements) must evaluate the guarantee to determine whether it also is in the scope of ASC 326. ASC 460 generally requires that a guarantee in its scope, including a guarantee also in the scope of ASC 326, be recorded at its fair value at inception, with certain exceptions. For guarantees that are also in the scope of ASC 326, entities must recognize the expected credit losses arising from the contingent aspect of the guarantee.

Like entities with financing receivables and contract assets, companies that issue guarantees in the scope of ASC 326 are required to consider reasonable and supportable forecasts of future economic conditions in the estimate of the contingent liability related to the expected loss under the guarantee.

#### ***Other assets***

Other assets for which impairment or similar guidance exists include:

- ▶ Equity securities (ASC 320 before the adoption of ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, and ASC 321 after the adoption of ASU 2016-01)
- ▶ Other investments (ASC 325)

- ▶ Capitalized costs of obtaining or fulfilling a contract with a customer (ASC 340-40)
- ▶ Programming inventory (ASC 920, *Entertainment – Broadcasters*, and ASC 926, *Entertainment – Films*)

#### ***Asset impairments not covered by other literature***

For asset impairments not addressed by other literature, ASC 450, *Contingencies*, provides guidance on the initial and subsequent measurement and recognition of loss contingencies.

### **How we see it**

When an affected company concludes that the effects of the COVID-19 pandemic trigger an impairment loss, the company should disclose the facts and circumstances leading to impairment. When other circumstances also contributed to a triggering event, companies should be transparent about all material circumstances contributing to the impairment or loss.

#### **Leases (updated 4 June 2020)**

While lessors follow the guidance on credit losses (i.e., ASC 310 or ASC 326, as applicable) to consider possible impairments of net investments in sales-type leases and direct financing leases, they need to follow the guidance in ASC 842 (if they adopted this standard), to evaluate the collectibility of lease payments (and any residual value guarantee) for operating leases.

Under that guidance, if a lessor determines that it is no longer probable that it will collect operating lease payments and any residual value guarantee from an affected lessee, the lessor's lease income is limited to the lesser of (1) the income that would have been recognized if collection were probable, including income from variable lease payments, and (2) the lease payments, including variable lease payments, that have been collected from the lessee. Lease income is reversed if the lease payments, including variable lease payments, that have been collected from the lessee are less than the lease income recognized to date.

Some lessors may provide or be required to provide consideration (e.g., deferral of lease payments, cash payments, reduced future lease payments) to existing lessees to help mitigate the economic fallout from the COVID-19 pandemic on the lessee's operations. To reduce the operational challenges and complexity of accounting for lease modifications at a time when many businesses have been ordered to close or have seen their revenue drop due to the impact of the COVID-19 pandemic, the FASB staff said in a question-and-answer document that entities that provide or receive rent concessions due to the impact of the COVID-19 pandemic can make certain elections. Entities that receive or provide lease-related concessions to mitigate the economic effects of COVID-19 on lessees need to consider whether to elect to not evaluate whether certain concessions provided by a lessor related to the impact of COVID-19 are lease modifications. Entities that elect not to evaluate whether a concession is a modification can then elect whether to apply the lease modification guidance in ASC 842 (or the legacy leases guidance, ASC 840, *Leases*, if applicable) to that concession (i.e., assume the concession was always contemplated by the contract or assume the concession was not contemplated by the contract).

Entities may make the elections for any lessor-provided concessions related to the effects of the COVID-19 pandemic as long as the concession does not result in a substantial increase in the rights of the lessor or the obligations of the lessee. For example, entities can make the elections for concessions that result in the total payments required by the modified contract being substantially the same as or less than the total payments in the existing lease.

Entities that don't make the elections need to apply the guidance in ASC 842 (or ASC 840, if they haven't adopted the new guidance yet) to determine whether a concession provided by a lessor should be accounted for as a lease modification.

Entities that provide or receive rent-related concessions should consider the objectives<sup>2</sup> in ASC 842 and provide disclosures that enable users to understand the nature and financial effect of material concessions related to the effects of the COVID-19 pandemic. Entities that are SEC registrants should also consider the SEC staff's guidance on disclosing the effects of COVID-19 and related risks. For example, we believe entities should disclose both their accounting policies for elections that have a material effect on the financial statements and the effects of those elections.

### How we see it

Entities should make sure they have appropriate internal controls to account for rent concessions related to the economic effects of the COVID-19 pandemic. Further, companies should document their policy for accounting for the concession and have controls over applying that policy consistently.

Refer to our Technical Line, [Accounting for rent concessions related to the COVID-19 pandemic under ASC 842](#), or our FRD, [Lease accounting \(ASC 842\)](#), or [Lease accounting \(ASC 840\) before the adoption of ASC 842](#), for more information.

### Exit or disposal activities (added 31 March 2020)

If there is prolonged business interruption, a company may decide to sell or abandon certain assets or execute a restructuring plan. ASC 420, *Exit or Disposal Cost Obligations*, addresses the accounting for costs associated with exit or disposal activities. Exit activities may include:

- ▶ The sale or termination of a line of business (e.g., by abandonment, exchange for other assets or a group of assets, distributions to owners in a spin-off, other forms of reorganization or liquidation)
- ▶ The closure of a business location in a country or region or the relocation of business activities from one country, region or facility to another
- ▶ Changes in management structure
- ▶ A fundamental reorganization that has a material effect on the nature and focus of a company's operations

The costs often incurred as part of an exit or disposal activity include employee termination benefits under a one-time termination plan (see the *Compensation* section below for other than one-time termination benefits), contract termination costs and costs to consolidate or close a facility and relocate employees. A liability for costs associated with an exit or disposal activity is recognized at fair value in the period the liability is incurred. For example, a liability to terminate a contract before the end of its term is recognized when the entity terminates the contract.

For entities that have already adopted ASC 842, ASC 420 excludes costs to terminate a contract that is a lease from the scope of that guidance. Therefore, when a company ceases to use an asset being leased, it will evaluate the recognized right-of-use asset for impairment in accordance with ASC 360. However, an entity that has not yet adopted ASC 842 will apply the guidance in ASC 420 and recognize a liability for costs that will continue to be incurred under an operating lease for its remaining term without economic benefit to the entity. These costs are recognized and measured at fair value when the entity ceases using the right conveyed by the lease.

Entities that don't make the elections may find it operationally challenging to evaluate the rights and obligations of each contract and apply the lease modification guidance if a concession was not contemplated in the existing lease.

It is important to note that the costs associated with temporarily vacating a facility are not subject to ASC 420. An evaluation of whether an entity has ceased using a facility permanently or temporarily is based on the facts and circumstances.

Costs associated with one-time employee termination benefits are measured at the time employees receive communication of the termination (in accordance with ASC 420-10-25-4) and are either recognized on the communication date or over the service period, depending on whether future services are required (in accordance with ASC 420-10-25-8 to 25-9). A liability for costs associated with closing a facility and relocating employees is not recorded until the costs are incurred.

Refer to our FRD, [\*\*\*Exit or disposal cost obligations\*\*\*](#), for additional information.

### **Fair value measurement (updated 31 March 2020)**

ASC 820 defines the term fair value and provides a principles-based framework for measuring fair value when US GAAP requires or permits a fair value measurement. For example, fair value measurements may be required when measuring impairment of long-lived assets, goodwill, indefinite-lived intangible assets and equity securities.

The objective of a fair value measurement is to determine the price at which an orderly transaction would take place between market participants under the market conditions that existed at the measurement date. While volatility in the financial markets may suggest that the prices are aberrations and do not reflect fair value, it would not be appropriate for a company to disregard market prices at the measurement date unless those prices are from transactions that are not orderly.

The concept of an orderly transaction is intended to distinguish a fair value measurement from the price in a distressed sale or forced liquidation. The intent is to convey the current value of the asset or liability at the measurement date, not its potential value at a future date. The objective of a fair value measurement does not change when markets have been volatile or inactive during a period of dislocation.

While there may be more transactions that are not orderly when a market has undergone a significant decrease in volume, it is not appropriate to assume that all transactions that occur in a market during a period of dislocation are distressed or forced. This determination is made at the individual transaction level and requires the use of judgment based on the facts and circumstances. While market factors such as an imbalance in supply and demand can affect the prices at which transactions occur in a given market, such an imbalance does not automatically indicate that the parties to a transaction were not knowledgeable and willing market participants or that a transaction was not orderly. Determining whether an observed transaction is orderly should be based on the available evidence from all relevant factors.

In addition, while a fair value measurement incorporates the assumptions that sellers, as well as buyers, would consider in pricing the asset or liability, a reporting entity's conclusion that it would not sell its own asset (or transfer its own liability) at prices currently observed in the market does not mean these transactions should be presumed to be distressed. ASC 820 makes clear that fair value is a market-based measurement, not an entity-specific measurement, and notes that the reporting entity's intention to hold an asset or liability is not relevant.

Refer to our FRD, [\*\*\*Fair value measurement\*\*\*](#), for more information on fair value measurements and related disclosures.

### Derivatives and hedge accounting (updated 4 June 2020)

Business transactions may be postponed or canceled, or they may occur in significantly lower volumes than initially forecasted. If a company has designated a transaction such as the purchase or sale of goods or the expected issuance of debt as a hedged forecasted transaction in a cash flow hedge accounted for under ASC 815, *Derivatives and Hedging*, the company will need to consider whether the transaction is still “probable of occurring,” whether the volume or amounts involved will be lower than forecasted or whether it is now probable that the forecasted transaction will not occur.

That is, if the effects of the pandemic affect the probability of hedged forecasted transactions occurring during the time period and in the amounts designated at the inception of a hedge, a company will need to determine whether it can still apply hedge accounting. In addition, if a company determines that it is probable that a forecasted transaction will not occur within the specified time period (or within an additional two-month period thereafter as stated in ASC 815-30-40-4), it has to immediately reclassify to earnings the balances from past changes in the fair value of derivative contracts that have been recorded in accumulated other comprehensive income (AOCI).

However, the guidance in ASC 815 includes an exception to this requirement when extenuating circumstances that are related to the nature of the forecasted transaction and are outside the control or influence of the reporting entity cause the forecasted transaction to be probable of occurring on a date that is beyond the additional two-month time period. In a question-and-answer document, the FASB staff stated that entities may apply this exception to forecasted transactions that are delayed due to the effects of the COVID-19 pandemic but noted that the determination of whether the delay is due to the effects of the pandemic will require judgment, based on the facts and circumstances.

Consequently, if a forecasted transaction delayed by the effects of COVID-19 is probable of occurring more than two months after the originally specified period, an entity should continue to retain amounts previously recorded in AOCI until the forecasted transaction affects earnings. However, the staff emphasized that the exception only applies to situations in which the forecasted transaction remains probable of occurring “over a time period that is reasonable given the nature of the entity’s business, the nature of the forecasted transaction, and the magnitude of the disruption to the entity’s business related to the effects of the COVID-19 pandemic.”

If an entity determines that it is not probable that the forecasted transaction will occur within a reasonable time period beyond the additional two-month period, the exception would not apply, and amounts previously recorded in AOCI would have to be reclassified into earnings immediately and disclosed in the entity’s interim and annual financial statements. In this situation, the FASB staff has stated that it would be acceptable for an entity not to consider missed forecasts related to the effects of the COVID-19 pandemic when determining whether it has exhibited a pattern of missed forecasts that would call into question its ability to accurately predict forecasted transactions and the propriety of using cash flow hedge accounting in the future for similar transactions.

Companies that apply cash flow hedge accounting should also remember that a loss recorded in AOCI must be immediately reclassified into earnings if at any time the continued reporting of this loss in AOCI would lead to the recognition of a net loss when the forecasted transaction affects earnings. For example, an entity would need to reclassify from AOCI into earnings a loss that relates to a hedge of a forecasted purchase of inventory if it expects to recognize a net loss when the inventory is sold (i.e., if the expected cost basis of the inventory plus the related loss on the hedging instrument reported in AOCI exceeds the amount expected to be recovered through the future sale of the inventory).

Companies need to consider whether the pandemic could affect their assessment of whether hedging relationships continue to be highly effective, given the volatility in prices for many asset classes.

Companies also need to consider whether the current market conditions could affect their assessment of whether hedging relationships continue to be highly effective, given the volatility in prices for many asset classes. This is particularly relevant when there are differences between the hedging instrument and the hedged item (e.g., hedging variable rate debt that contains an embedded floor with an interest rate swap that does not contain a floor, hedging forecasted purchases of jet fuel with crude oil derivatives). Current market conditions may also represent a change in facts and circumstances that requires an entity to switch from a qualitative to quantitative method of assessing hedge effectiveness.

Changes in a derivative counterparty's credit risk or an entity's own nonperformance risk also could affect fair value estimates of derivatives and hedge effectiveness. A fundamental requirement is that a hedging relationship, both at inception and on an ongoing basis, is expected to be highly effective in offsetting changes in fair value or cash flows attributable to the hedged risk during the period that the hedge is designated.

In addition to the hedge accounting considerations noted above, companies that have elected to apply the normal purchases and normal sales (NPNS) scope exception to contracts that would otherwise be accounted for as derivative instruments should determine whether it remains probable that these contracts will result in physical delivery and not net settle. A decrease in the company's or its customer's need for a commodity (e.g., natural gas or oil) in the amount specified in the contract could result in the contract being partially net settled. If the requirements to apply the NPNS scope exception are no longer met, the contract would subsequently be accounted for as a derivative instrument (i.e., at fair value).

Refer to our To the Point publication, [\*FASB staff clarifies accounting for cash flow hedges disrupted by the COVID-19 pandemic\*](#), and our FRD, [\*Derivatives and hedging \(after the adoption of ASU 2017-12\)\*](#), for additional information.

### **Debt modifications and loan covenants (updated 4 June 2020)**

Affected companies may experience cash flow challenges as a result of disruptions in their operations, higher operating costs or lost revenues. They may need to obtain additional financing, amend the terms of existing debt agreements or obtain waivers if they no longer satisfy debt covenants.

Affected companies may need to consider the debt guidance in ASC 470-50, *Debt – Modifications and Extinguishments*, and ASC 470-60, *Debt – Troubled Debt Restructurings by Debtors*, to determine whether a change to an existing debt arrangement represents a troubled debt restructuring (TDR), a debt modification or potentially a debt extinguishment, each of which would have different accounting implications. In certain circumstances, debtors also may be able to consider the guidance the banking regulators issued for creditors to determine whether a modification is a TDR, as discussed further below. In addition, they may need to consider the guidance in ASC 470-10-45 on the classification of long-term debt when there has been a covenant violation or other default at the balance sheet date.

Creditors that modify the terms of debt agreements should consider the guidance in ASC 310-40, *Receivables – Troubled Debt Restructurings by Creditors*, to determine whether the modifications are TDRs. For modifications that are not TDRs, entities should apply the guidance in ASC 310-20, *Receivables – Nonrefundable Fees and Other Costs*, to determine whether they should be accounted for as new lending arrangements or the continuation of the original arrangements and to determine the appropriate accounting for both unamortized and any new loan origination fees and costs.

Financial institutions may elect to apply Section 4013 of the CARES Act and suspend TDR accounting and reporting requirements for certain loan modifications that are related to COVID-19 (i.e. forbearance, interest rate modifications, repayment plans or any other similar

arrangements that defer or delay payment). The modifications must be made during the period beginning on 1 March 2020 and ending on the earlier of 31 December 2020 or 60 days after the national emergency is lifted, and the borrowers must have been less than 30 days past due on 31 December 2019. The CARES Act does not define the term “financial institution.” Entities may need to discuss with their legal counsel whether they can apply Section 4013 of the CARES Act.

SEC Chief Accountant Sagar Teotia has issued a statement saying that the SEC staff will not object to an eligible entity concluding that electing to apply the temporary relief of TDR accounting and reporting provided by the CARES Act is in accordance with US GAAP.

Lenders that determine that their modifications are not eligible for the relief from TDR accounting under Section 4013 of the CARES Act (e.g., they determine they are not financial institutions) or elect not to apply it can consider the interagency statement issued by the federal and state banking regulators<sup>3</sup> in **March 2020** and revised in **April 2020**. The statement provides guidance on accounting for loan modifications related to COVID-19.

The guidance in the statement, which was developed in consultation with the FASB staff,<sup>4</sup> indicates that short-term loan modifications (e.g., deferral of payments) made to help borrowers that are current on existing loans, either individually or as part of a program for creditworthy borrowers who are experiencing short-term financial or operational problems as a result of COVID-19, generally would not be considered TDRs. While the statement is intended for financial institutions subject to regulation by the banking regulators, we believe it can be applied by all entities that lend or otherwise provide credit.

Questions have been raised about whether borrowers can also apply the guidance in the statement to conclude that a modification is not a TDR in the scope of ASC 470-60. Based on a discussion with the FASB staff, borrowers that modify debt agreements under a modification or deferral program mandated by the federal government or a state government related to COVID-19 may conclude that the modification is not a TDR under ASC 470-60. However, if a modification is not the result of a government mandate, a borrower is not permitted to apply the guidance in the statement by analogy and conclude that the modification is not a TDR. In this situation, the borrower should consider the guidance in ASC 470-60 to determine whether the modification is a TDR.

During the FASB meeting on 8 April 2020, the FASB staff described its response to a technical inquiry on how a financial institution should account for interest income if it provides a payment holiday during which interest is not accrued for a borrower affected by COVID-19 and the payment holiday is not considered a TDR. The FASB staff said such a financial institution may either (1) determine a new effective interest rate and recognize interest income on the loan during the payment holiday or (2) not recognize any interest income during the payment holiday and resume recognition of interest income based on the contractual terms of the loan when the payment holiday ends.

### **Assets purchased with credit deterioration (added 4 June 2020)**

ASC 326 provides special initial recognition and measurement (Day 1) accounting for certain purchased assets that have experienced more-than-insignificant deterioration in credit quality since their origination. These assets are known as assets purchased with credit deterioration or PCD assets. Companies acquiring financial assets or portfolios of financial assets (i.e., financing receivables, AFS and HTM securities, beneficial interests) should consider the guidance in ASC 326 to determine whether the assets are PCD assets. Changes in broad market conditions or the outlook for an industry or geographical area could be indicators of a deterioration in credit quality before more objective indicators (e.g., delinquency) are observed. Given the

economic fallout and uncertainty related to the pandemic, companies that are completing transactions they agreed to before the pandemic may need to reconsider any preliminary conclusions they made about whether the assets are PCD.

### **Foreign currency matters – intercompany transactions of a long-term investment nature (added 31 March 2020)**

When an intercompany foreign currency transaction is of a “long-term investment” nature, foreign currency transaction gains and losses are reported in other comprehensive income rather than through income when the parties to the transaction are consolidated, combined or accounted for by the equity method in the reporting entity’s financial statements. To be considered a long-term investment, an intercompany balance must continually meet the condition that settlement is neither planned nor anticipated in the foreseeable future. A company affected by the COVID-19 pandemic and current market conditions may need to reassess whether an intercompany balance continues to qualify as a long-term investment.

A company’s reassessment of its liquidity needs or a planned restructuring or relocation of foreign operations, could be examples of changes in circumstances that could change the nature of an intercompany transaction from a long-term investment to one for which settlement becomes planned or anticipated. If a change in circumstances leads to such a change, then foreign currency transaction gains and losses on the transaction should be recorded in earnings prospectively. Foreign currency transaction gains and losses recorded in other comprehensive income during the period for which settlement was not planned or anticipated remain in other comprehensive income and are not immediately reclassified to earnings. Refer to our FRD, [\*\*\*Foreign currency matters\*\*\*](#), for more information.

### **Revenue recognition (updated 4 June 2020)**

The COVID-19 pandemic likely will affect various aspects of an entity’s revenue accounting under ASC 606, *Revenue from Contracts with Customers*.

Refer to our FRD, [\*\*\*Revenue from contracts with customers \(ASC 606\)\*\*\*](#), which provides more information about all of the following topics.

#### ***Variable consideration***

Estimates of variable consideration in new and ongoing customer contracts will need to be evaluated considering current circumstances. Examples of variable consideration estimates that may have changed due to the pandemic include expected returns of goods and expectations about both contract volumes and whether an entity will meet contractual conditions for performance bonuses or penalties.

When a contract with a customer includes variable consideration, an entity is generally required to estimate, at contract inception, the amount of consideration to which it will be entitled in exchange for transferring promised goods or services. The amount of variable consideration an entity can include in the transaction price is constrained to the amount for which it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainties related to the variability are resolved.

An entity that makes such an estimate at contract inception is also required to update the estimate throughout the term of the contract to depict conditions that exist at each reporting date. This will involve updating the estimate of variable consideration (including any amounts that are constrained) to reflect an entity’s revised expectations about the amount of consideration to which it expects to be entitled, considering uncertainties that are resolved or new information about uncertainties related to the COVID-19 pandemic.

Changes to the transaction price that relate to a change in estimates of variable consideration (and are not a result of contract modifications, which are discussed below) generally are allocated to the performance obligations on the same basis as their initial allocation. That is, they are allocated based on the relative standalone selling price (i.e., using the same proportionate share of the total in the initial allocation) or they are allocated to individual performance obligations under the variable consideration allocation exception. Further, any amounts allocated to satisfied (or partially satisfied) performance obligations should be recognized in revenue in the period in which the transaction price changes (i.e., on a cumulative catch-up basis). This could result in either an increase or decrease in revenue in relation to a satisfied performance obligation or in cumulative revenue recognized for a partially satisfied over-time performance obligation. Entities using the variable consideration allocation exception should also consider whether they can continue to apply this exception.

#### ***Contract modifications and terminations***

Uncertainties related to the COVID-19 pandemic and current market conditions may prompt entities to modify contracts with customers. Customers and entities may also be more likely to terminate contracts (either fully or partially). Contract terminations are considered a form of contract modification under ASC 606. A contract modification occurs when the parties to a contract agree to amend the scope or price (or both) of a contract, and the amendments either create new enforceable rights and obligations of the parties or change their existing rights and obligations.

An entity should account for a contract modification under the guidance in ASC 606-10-25-10 through 25-13. Under this guidance, certain modifications are treated as separate, standalone contracts, while others are combined with the original contract and accounted for as one contract. In addition, some modifications are accounted for prospectively, while others are accounted for on a cumulative catch-up basis.

Generally, it is clear when a contract modification has taken place, but in some circumstances, that determination requires judgment. For example, an entity will need to account for a contract modification before the parties reach final agreement if the negotiations create enforceable rights and obligations. In addition, contract modifications can be implied by customary business practices as long as the changes either create new enforceable rights and obligations in the contract or change existing rights and obligations.

Entities also have to determine whether a new contract with an existing customer is a modification of an existing contract. We believe that, when entities make this determination, they should consider the facts and circumstances, as well as the factors included in the contract combination requirements in ASC 606-10-25-9.

When an ASC 606 contract is modified, we believe that may indicate that “a significant change in facts and circumstances” has occurred (see ASC 606-10-25-5) and that the entity should reassess the criteria in ASC 606-10-25-1 for the modified contract as well as the contract’s duration (i.e., the period in which parties to the contract have present enforceable rights and obligations). The accounting for any reassessment is prospective, and the reassessment would not change the conclusions associated with goods and services already transferred. That is, an entity would not reverse any receivables, revenue or contract assets already recognized under the contract because of the reassessment.

#### ***Collectibility and extended payment terms***

The COVID-19 pandemic may impact customers’ ability and intent to pay, and/or entities may be more willing to accept partial payment or extend payment terms. Entities will need to determine how to account for these circumstances. Specifically, as discussed below, entities

ASC 606 contains specific guidance on the accounting for contract modifications.

will need to consider the effects on their ASC 606 collectibility assessments, estimates of variable consideration made at contract inception, credit loss reserve calculations (see *Financing receivables and contract assets* above) and identification of significant financing components. Entities will also need to consider whether any changes to contracts with existing customers need to be accounted for as contract modifications, as discussed above.

Entities entering into new contracts with customers will need to carefully consider their customer's ability and intent to pay. In order for an arrangement to be accounted for as a revenue contract under ASC 606, it must be probable that the entity will collect substantially all of the consideration to which it expects to be entitled in exchange for the goods or services that will be transferred to the customer. In performing this collectibility assessment under ASC 606, entities will first need to determine the transaction price in Step 3 of the model. The contract price and transaction price will differ if an entity concludes, at contract inception, that it has offered or is willing to accept a price concession (a form of variable consideration). An entity may accept a lower price than the amount stated in the contract to develop or enhance a customer relationship, or the customer may have a reasonable expectation that the entity will reduce its price based on the entity's customary business practices. An entity deducts from its contract price any estimated price concessions to derive the transaction price at contract inception (i.e., the amount the entity expects to be entitled in exchange for the goods or services that will be transferred to the customer). The ASC 606 collectibility assessment is then performed on the transaction price. An entity also has to determine whether an allowance for credit losses is required under ASC 310 or ASC 326 (if adopted).

When the amount an entity expects to collect changes subsequent to contract inception, the entity may need to exercise significant judgment to determine whether that change is due to (1) a change in estimate of the variable consideration identified at contract inception (and, therefore, accounted for as a change in the transaction price) or (2) an identifiable credit event (e.g., a known decline in a customer's operations, a bankruptcy filing) that should be accounted for as bad debt (i.e., outside of revenue). This determination will likely require entities to establish policies to differentiate between price concessions and customer credit events. When the terms of contracts with existing customers change, entities also need to determine whether there is a contract modification (as discussed above).

Entities also will need to exercise judgment to determine whether changes in the facts and circumstances related to a customer's ability and intent to pay the consideration in the contract are significant enough to indicate that a contract no longer exists and revenue should no longer be recognized. This is because ASC 606 requires an entity to reassess whether it is probable that it will collect the consideration to which it will be entitled when significant facts and circumstances change.

Offering extended payment terms to new or existing customers may also indicate that the contract includes a significant financing component. When there is a significant financing component, an entity needs to adjust the transaction price for the effects of the time value of money if the timing of payments agreed to by the parties in the contract provides the customer or the entity with a significant financing benefit.

### ***Customer incentives***

Entities may provide additional incentives, such as free goods or services or cash payments to customers, to spur demand. In response to customer needs, entities may also change the pricing of their goods and services or hold finished goods for customers that are unable to receive them.

The accounting for free goods and services offered to customers will depend on the facts and circumstances of the offer. An offer that creates new enforceable rights and obligations of the parties to an existing contract or changes existing rights and obligations is accounted for as a contract modification, as discussed above. In some cases, an offer may not result in a contract modification and would be accounted for as a marketing offer (i.e., expense).

When an entity determines whether the offer creates new enforceable rights and obligations or changes the rights and obligations of the existing contract with a customer, the following non-exhaustive considerations will likely be relevant:

- ▶ Is the offer the result of negotiations with a specific customer or group of customers?
- ▶ Is the same offer available to both existing customers and noncustomers?
- ▶ If an offer is only available to existing customers, is it available to a broad group of current customers (or all current customers) and not the result of an individual customer's negotiations?
- ▶ Does the entity have the right to rescind the offer?

In addition, we believe that the accounting principles for determining when contracts should be combined under ASC 606-10-25-9 will be helpful when determining whether an offer for free goods or services to an existing customer is a contract modification.

Entities will need to consider any consideration paid or payable to a customer and account for such payments as a reduction of the transaction price (and, therefore, revenue) unless the payment to the customer is in exchange for a distinct good or service that the customer transfers to the entity.

Further, if an entity changes the pricing of its goods and services, it will need to determine whether the standalone selling prices of its goods and services should be updated for new contracts or upon certain contract modifications. Standalone selling prices are determined at contract inception and are not updated unless the contract has been modified (and the modification is not treated as part of the existing contract).

Finally, entities will need to determine any effect on the timing of revenue recognition resulting from customers' requests to hold finished goods at the entity's site. Entities will need to consider the bill-and-hold guidance in ASC 606-10-55-81 through 55-84, which includes criteria that must be met (in addition to the control indicators in ASC 606-10-25-30) for revenue to be recognized for the sale of a good in a bill-and-hold arrangement.

### ***Disclosure***

Entities should consider whether uncertainties or changes in business practices due to the economic impact of the COVID-19 pandemic require their revenue disclosures to be enhanced. For example, if an entity estimates variable consideration (including application of the constraint), it is required to disclose information about the methods, inputs and assumptions used. Entities are also required to disclose certain information about their performance obligations, including when performance obligations are satisfied in a bill-and-hold arrangement and significant payment terms. Entities should also consider the requirements to disclose the judgments and changes in judgments that significantly affect the determination of the amount and timing of revenue.

## Insurance recoveries

Entities often maintain insurance to mitigate losses associated with property damage (property and casualty loss) or a business interruption, such as lost revenue during extended periods of suspended operations or stemming from supply chain interruption (i.e., business interruption insurance).

The accounting for insurance claims varies, depending on factors such as the nature of the claim, the amount of proceeds (or anticipated proceeds), and the timing of the loss and recovery.

Accounting for any potential insurance recovery needs to be carefully evaluated. That is, companies need to analyze the terms of their insurance policies and the ability of an insurer to satisfy a claim. For example, while insurance may cover interruptions of deliveries of raw materials, recoveries are often limited to losses stemming from certain suppliers specified in the policy. Further, the policy may contain exclusions for events, such as pandemics, that cause business interruptions.

### How we see it

Anticipated reimbursements for business interruption (e.g., lost revenue) are considered gain contingencies and are subject to the guidance in ASC 450-30, *Contingencies – Gain Contingencies*. This guidance requires that all contingencies must be resolved before such a reimbursement can be recognized in earnings. The contingencies would be considered resolved only if the proceeds have been received or if confirmation of the amount of the proceeds has been received from the insurer.

If a company determines it has incurred property and casualty losses as a result of the pandemic, any insurance recoveries would be recognized when the company believes it is probable<sup>5</sup> that the insurer will settle the claim. Receipts from insurance up to the amount of the loss recognized are considered recoveries. Insurance recoveries should not be recognized before the related cost is recognized.

Anticipated proceeds in excess of the amount of loss recognized would be considered a gain and would be subject to the gain contingency guidance in ASC 450-30. Anticipated proceeds in excess of a loss recognized in the financial statements may not be recognized until all contingencies related to the insurance claim are resolved. We believe insurance recoveries for temporary relocation costs would be treated as recoveries of property and casualty losses.

## Future operating losses

While affected companies may account for some effects of the pandemic in the current period, other direct and indirect effects, such as losses or lost revenue, may need to be accounted for in subsequent periods. Companies may anticipate losses that are directly or indirectly related to the current pandemic. These might include losses related to significant reduction in demand, supply chain disruptions and losses due to an overall decline in economic output. Future operating losses do not meet the definition of a liability and, therefore, should not be recognized until the losses are incurred; however, affected registrants may need to consider whether additional disclosures are required.

## Compensation (added 31 March 2020)

The COVID-19 pandemic may affect compensation in a variety of ways, including short-term employment benefits, postemployment benefits (provided after employment but before retirement), postretirement benefits (provided through a pension plan or other postretirement benefit plan) and share-based payments.

**Short-term employment benefits**

Companies may provide employees with short-term benefits due to the coronavirus pandemic, or they may be required to provide benefits by related legislation, such as the Families First Coronavirus Response Act. This can include benefits to furloughed employees (those on temporary leave), additional sick pay benefits or childcare benefits. Companies should evaluate the benefits they are providing to determine the appropriate accounting for the costs.

Some companies may provide benefits, such as salary continuation, to furloughed employees. These companies should record an accrual for the expected cost of these benefits when it is probable that the benefits will be paid and the cost of the benefits can be reasonably estimated. In measuring the liability for these benefits, companies must estimate the length of time the employee is expected to receive the benefits. This estimate should be updated at each balance sheet date.

Companies may also provide other benefits, such as additional sick pay. The accounting for the cost of these benefits will depend on whether the benefits can be carried forward by the employee to one or more periods after they are earned (i.e., whether the benefits accumulate) and whether the company is obligated to make payments for the benefits when the employee is terminated (i.e., whether the benefits vest). Generally, benefits such as sick pay don't vest or accumulate. In these cases, companies should recognize the cost of the benefits at the time an employee is absent. If the benefits vest, an accrual for the cost of the benefits should be recognized when the conditions in ASC 710-20-25-1 are met. However, if sick benefits accumulate, but do not vest, an accrual is permitted but not required.

Companies may also provide other benefits such as childcare benefits. These benefits are provided to employees while they are working rather than when they are absent from work. Generally, companies recognize the cost of these benefits in the period the benefits are used by employees.

**Postemployment benefits**

Postemployment benefits include termination or severance benefits, supplemental unemployment benefits and continuation of medical, life, dental and vision benefits.

There are several standards that address the accounting for postemployment benefits. If the benefits are an enhancement of benefits provided through a pension or other postretirement benefit plan, the benefits should be accounted for under ASC 715, *Compensation – Retirement Benefits*. If the benefits are provided to employees involuntarily terminated under a one-time benefit arrangement, they should be accounted for under ASC 420 (see the *Exit or disposal activities* section above). If the benefits are provided as part of an ongoing benefit arrangement or in exchange for voluntary termination, they should be accounted for under ASC 712, *Compensation – Nonretirement Postemployment Benefits*.

The current economic conditions may be a triggering event for the recognition of ASC 712 postemployment benefits. However, the timing of recognition of these benefits depends on whether the benefits are contractual termination benefits, special termination benefits or don't fall into either category.

Special termination benefits are offered only for a short period of time and are recognized when the employee accepts the offer and the amount can be reasonably estimated. Contractual termination benefits are required by the terms of an existing arrangement only if a specified event (such as a plant closing) causes the employee's services to be terminated involuntarily. Contractual termination benefits are recognized when it is probable that the employee will be entitled to the benefits and the amount can be reasonably estimated.

Benefits other than special or contractual termination benefits that do not accumulate are generally accrued when the conditions in ASC 450-20-25-2 are met (i.e., it is probable the employee will be terminated, and the cost can be reasonably estimated).

The cost of postemployment benefits other than special or contractual termination benefits that accumulate may be accrued over the employee's service period. Companies that have accruals for these types of benefits should evaluate whether they need to update their estimates for changes in assumptions as a result of the COVID-19 pandemic.

#### ***Postretirement benefits***

The measurement of postretirement plan assets and obligations generally occurs at the end of the fiscal year, based on market prices, discount rates and other actuarial assumptions at the measurement date. If certain events occur during an interim period (e.g., the company amends the plan), the company is required to perform a remeasurement at the time of the event. A company is not required to remeasure its plan obligations and assets solely due to changes in the fair value of plan assets due to the current market conditions.

Companies that are measuring their postretirement obligation for year-end reporting or due to an event such as a plan amendment that triggers an interim remeasurement should reflect the declines in equity markets, interest rates and other changes in assumptions related to the current market conditions in their calculations.

The discount rate used to measure the postretirement obligation should be based on bonds that are of high quality (e.g., Moody's Aa rating or higher). Bonds that were considered high-quality at the measurement date may have been (or may soon be) downgraded and may no longer be considered high quality. If a bond is no longer considered high quality because of events that existed at the balance sheet date, companies should consider excluding the bond from their discount rate assumption. If a bond selected at the measurement date was on "watch" for potential downgrade, that may indicate that the conditions that resulted in a downgrade existed as of the measurement date.

#### **How we see it**

Companies that recognize gains and losses immediately in net periodic benefit cost in connection with their annual measurement may need to consider interim MD&A disclosures, even if remeasurement is not required. For example, if a company was not required to remeasure its plan assets and obligation in an interim period but there is a risk that the economic conditions related to the COVID-19 pandemic could result in a significant remeasurement loss at year end, the company should consider disclosing this in the interim period MD&A.

#### ***Share-based payment***

Companies that grant share-based payment awards with performance conditions recognize the related compensation cost over the employee's requisite service period or the nonemployee's vesting period when it is probable<sup>5</sup> that the performance condition will be satisfied. Probability is assessed at each reporting date, and changes in estimate are accounted for in the period of the change through a cumulative catch-up adjustment. Companies must consider updated forecasts to assess whether performance conditions based on metrics that have been affected by the COVID-19 pandemic (e.g., sales, EBITDA) will be satisfied. If a performance condition changes from being probable to improbable, the company reverses previously recognized compensation cost in the period in which the assessment changes.

Companies are not required to remeasure plan obligations and assets solely due to changes in the fair value of plan assets that result from current market conditions.

Companies that grant share-based payment awards with conditions related to achieving a specified price of the company's shares include that market condition in the estimate of the grant-date fair value. The related compensation cost is recognized over the employee's derived service period or the nonemployee's vesting period. If the service is rendered or goods are delivered, compensation cost must be recognized even if the market condition is not achieved (i.e., previously recognized expense is not reversed just because stock prices decline).

Because the uncertainty related to the pandemic has resulted in a significant decline in business activity and stock prices, companies may amend the terms and/or conditions of share-based payment awards to keep grantees incentivized. If amendments to the terms and conditions of an award change the fair value, vesting conditions or classification of an award, the company must apply modification accounting. When applying modification accounting, a company generally must determine on the date of the modification whether, based on *current* circumstances, it is probable that the awards would vest under either the original vesting conditions, the new vesting conditions or both.

If a company amends an award by lowering the target of performance conditions because the original target is no longer probable of being met and management believes it is probable the new target will be met, the modification is a Type III modification (improbable-to-probable). In this case, the grant-date fair value of the original award is no longer relevant, and the modification date fair value of the modified award would be recognized if the award ultimately vests, regardless of whether the fair value of the modified award is greater than or less than the grant-date fair value of the original award. The accounting would be the same, even if it was not probable at the modification date that the new target will be met but the target is ultimately met.

Given the decline in share prices, companies may amend the terms and conditions of awards (e.g., reduce option exercise prices, extend option exercise periods). If an award is modified to reduce the exercise price or extend the exercise period and the award is expected to vest under its original and modified terms, the modification is a Type I modification (probable-to-probable). In this case, the compensation cost recognized if either the original or new vesting condition is achieved cannot be less than the grant date fair value of the original award. Additionally, the incremental compensation cost associated with the modification is recognized if the modified vesting condition is satisfied.

Companies may also amend the terms and conditions of awards with market conditions by, for example, reducing the share price targets. But when a market condition is modified, the probability of satisfying the original condition does not affect the total compensation cost that will be recognized as it does for modifications of a service or performance condition. The total compensation cost measured at the date of a modification is (1) the portion of the grant-date fair value of the original award for which the promised good is expected to be delivered (or has already been delivered) or service is expected to be rendered (or has already been rendered) at that date, plus (2) the incremental cost resulting from the modification. As a result, the total compensation cost recognized for a modified award with only a market condition will never be less than the grant-date fair value of the original award. Additionally, the effect of the modification on the number of instruments expected to vest must be considered when measuring incremental compensation cost.

Modifying share-based payments can have tax consequences. Accordingly, companies should consult with their tax advisors before modifying share-based payments.

Refer to our FRD publications, [\*Share-based payment \(after the adoption of ASU 2018-07, Improvements to Nonemployee Share-Based Payment Accounting\)\*](#) or [\*Share-based payment \(before the adoption of ASU 2018-07, Improvements to Nonemployee Share-Based Payment Accounting\)\*](#), for more information.

## Income taxes (updated 4 June 2020)

In response to the COVID-19 pandemic, many governments are contemplating measures to provide aid and economic stimulus. These measures may include deferring the due dates of tax payments or other changes to their income and non-income-based tax laws. The CARES Act, which was enacted on 27 March 2020 in the US, includes many measures to assist companies, including temporary changes to income and non-income-based tax laws. Some of the key tax-related provisions of the bill include:

- ▶ Eliminating the 80% of taxable income limitations by allowing corporate entities to fully utilize net operating loss (NOL) carryforwards to offset taxable income in 2018, 2019 or 2020. The 80% limitation is reinstated for tax years after 2020
- ▶ Allowing NOLs originating in 2018, 2019 or 2020 to be carried back five years
- ▶ Increasing the net interest expense deduction limit to 50% of adjusted taxable income from 30% for tax years beginning 1 January 2019 and 2020
- ▶ Allowing taxpayers with alternative minimum tax credits to claim a refund in 2020 for the entire amount of the credit instead of recovering the credit through refunds over a period of years, as originally enacted by the Tax Cut and Jobs Act (TCJA) in 2017
- ▶ Allowing companies to deduct more of their cash charitable contributions paid during calendar year 2020 by increasing the taxable income limitation from 10% to 25%

In addition to the income tax provisions noted above, the CARES Act provides non-income tax relief, such as allowing payments of the employer share of Social Security payroll taxes that would otherwise be due from the date of enactment through 31 December 2020 to be paid over the following two years. Another provision provides an Employee Retention Credit (ERC) that allows eligible employers to receive a 50% credit on qualified wages against their employment taxes each quarter. See further discussion of the ERC below under *Government assistance*.

A careful analysis of the CARES Act requirements is necessary to determine eligibility and application of the measures noted above.

### ***Enactment of tax law changes***

ASC 740 requires the effect of changes in tax rates and laws on deferred tax balances to be recognized in the period in which new legislations is enacted. In the case of US federal income taxes, the enactment date is the date the bill becomes law, which generally is upon presidential signature. Determining the enactment date in other jurisdictions will require an understanding of the legislative process in those jurisdictions. For purposes of applying ASC 740, the enactment date is when all steps in the process for legislation to become law have been completed. Refer to section 8 of our FRD, [\*\*Income taxes\*\*](#) for additional considerations on the accounting for tax law changes.

The tax effect of a change in tax law or rates on taxes payable or refundable for a prior year should be recognized as of the enactment date as tax expense (benefit) for the current year. The effect of a change in tax laws or rates on taxes currently payable or refundable for the current year is recorded after the effective date and reflected in the computation of the annual effective tax rate beginning no earlier than the first interim period that includes the enactment date.

***Accounting considerations related to the tax-related provisions of the CARES Act***

Companies will need to account for the income tax provisions of the CARES Act in the period that includes 27 March 2020 (i.e., the first quarter for calendar year-end companies). Certain income tax provisions of the CARES Act are retroactive to earlier years. For example, the law allows companies to carry back losses in 2018 or 2019 for a period of five years or increase interest deduction limitations in 2019.

Companies that utilized NOL carryforwards from post-tax-reform years to offset taxable income in 2019 will need to consider whether they can further offset additional taxable income in those years, due to the temporary elimination of the 80% limitation on NOL carryforwards and carry backs.

Companies with federal NOL carrybacks originating in 2018 and 2019 that expect to carry back those losses to earlier years will need to adjust the carrying amount of the deferred tax assets related to their NOLs. This is because the NOLs originating in 2018 and 2019 were initially measured at the current US corporate tax rate of 21%; however, these NOLs may now be carried back to offset taxable income that was taxed at a 35% tax rate. Companies that expect to carry back losses should reclassify the amount of tax affected NOLs they expect to offset against a prior year's taxable income to income tax receivable (or reduction in income taxes payable) if they expect a refund within the next 12 months. In addition, companies that have deferred tax assets for disallowed interest deductions originating in 2019 may need to consider whether the temporary increase in the interest deduction limitations changes the amount of NOLs originating in 2019 to be carried back. Companies that carryback NOLs and were subject to the transition tax under TCJA (i.e., section 965) will need to perform additional analysis to understand how the changes to the NOL carryback rules in the CARES Act affect them.

Companies may also need to reevaluate valuation allowance conclusions in the period that includes the enactment date because of the CARES Act's temporary changes to the NOL carryback, 80% limitation on the deduction of NOLs and interest deduction limitation rules. Under the TCJA, companies were not permitted to carryback losses after the effective date of the TCJA NOL provisions. As a result, companies were not able to consider taxable income in carry back periods as a source of taxable income (source 1 or source 2) when evaluating the realizability of their NOLs. In addition, when evaluating future sources of taxable income from the reversal of taxable temporary differences, tax planning strategies or projections of future taxable income (exclusive of reversing temporary differences), prior to the CARES Act companies would need to consider the limitations on the use of their NOLs to 80% of their taxable income. Because of the temporary measures in the CARES Act, companies may reach different conclusions regarding the realizability of their deferred tax assets. Refer to sections 6.3 and 6.4 of our FRD, ***Income taxes***, for additional discussion on using carrybacks and carryforwards when evaluating the realizability of deferred tax assets.

For interim reporting, the effects from adjusting deferred tax assets or changes to valuation allowances due to the CARES Act should be recognized as a component of income taxes expense or benefit from continuing operations in the interim period that includes 27 March 2020 and should not be allocated to subsequent interim periods by an adjustment of the estimated annual effective tax rate. Companies that expect to have taxable losses for 2020 and have taxable income in periods earlier than 2018 may be able to benefit from those losses at a 35% tax rate rather than the current US corporate tax rate of 21%.

### ***Income tax accounting considerations due to current market conditions***

#### ***Indefinite reinvestment assertion***

Companies that assert their intent and ability to indefinitely reinvest foreign earnings should challenge whether they can continue to do so if their operations in such a country have been affected by the COVID-19 pandemic or current market conditions.

The assertion that earnings from foreign operations will be indefinitely reinvested should be supported by projected working capital and long-term capital needs in the locations in which those earnings are generated (or other foreign locations) and an analysis of why those funds are not needed upstream. Although companies may have historically been able to demonstrate their ability to indefinitely reinvest foreign earnings, changing market conditions may call into question a company's ability to continue to indefinitely reinvest foreign earnings, particularly if a company is shifting the location of operations.

If a company changes its reinvestment assertion during an interim period, the deferred income tax effects of undistributed earnings related to prior years, including any deferred income tax effects of the beginning-of-the-year cumulative translation adjustment related to the investment (i.e., the outside basis difference on the company's investment in a foreign subsidiary as of the beginning of the year), should be reported in continuing operations as a discrete charge to income tax expense in the period in which the change in assertion occurs. The backward tracing of the tax effects of the beginning-of-the-year cumulative translation adjustment to AOCI would not be appropriate.

The tax effects of undistributed earnings, including translation adjustments related to the current year (i.e., the outside basis difference related to the current reporting year), would be recognized as an adjustment to the estimated annual effective tax rate in the period in which the change in assertion occurs. The deferred tax effects of the translation adjustment related to the current period should be reported in other comprehensive income in accordance with ASC 740-20-45-11.

#### ***Realizability of deferred tax assets and carryforwards***

Companies affected by current market conditions related to the COVID-19 pandemic may be incurring unexpected losses and may need to reevaluate and change their conclusions about the realizability of their deferred tax assets. Future realization of deferred tax assets ultimately depends on the existence of sufficient taxable income of the appropriate character in either the carryback (if permitted under the tax law) or carryforward period under the tax law. Determining whether a valuation allowance for deferred tax assets is necessary often requires an extensive analysis of positive and negative evidence regarding the realization of the deferred tax assets, including an assessment of the likelihood of sufficient future taxable income.

ASC 740, *Income Taxes*, lists the following four possible sources of taxable income that should be considered in determining whether a valuation allowance is required:

- ▶ Taxable income in prior carryback year(s), if carryback is permitted under the tax law
- ▶ Future reversals of existing taxable temporary differences
- ▶ Tax-planning strategies
- ▶ Future taxable income exclusive of reversing temporary differences and carryforwards

Companies that expect to be in a cumulative loss position based on revised forecasts that reflect the effects of the pandemic should consider this negative evidence about the realizability of deferred tax assets.

ASC 740 states that recent cumulative losses or the expectation that a company will have cumulative losses constitutes significant negative evidence about the realizability of deferred tax assets that is difficult to overcome. We do not believe that, for the purpose of this assessment, there is a significant difference between being in a cumulative loss position and expecting to be in one. Therefore, a company that currently is not in a cumulative loss position but expects to be in such a position based on a revised forecast that reflects current market conditions should consider the negative evidence of the expected cumulative losses in the same manner as a company that is already in a cumulative loss position.

For entities that prepare interim financial statements, ASC 740 requires that the effect of a change in the beginning-of-the-year balance of a valuation allowance as a result of a change in judgment about the realizability of the related deferred tax asset in future years be recognized as a discrete event in the interim period that the change in judgement is made and not apportioned to other interim periods.

Management should also consider whether the disclosures made in the notes to the financial statements and MD&A regarding the realizability of the company's deferred tax assets are sufficient, especially if the company changes its assessment of the realizability of its deferred tax assets from the prior reporting period because of significant losses in the year-to-date period and/or changes to its expectations about sufficient taxable income in the future.

#### *Accounting for income taxes in an interim period*

A company is required at the end of each interim reporting period to make its best estimate of the annual effective tax rate for the full fiscal year and use that rate to provide for income taxes on a current year-to-date basis. The annual effective tax rate is applied to ordinary income. Ordinary income (or loss) refers to income (or loss) from continuing operations before income taxes (or benefits), excluding significant unusual or infrequently occurring items (as these terms are defined in ASC 220-20, *Income Statement – Reporting Comprehensive Income – Unusual or Infrequently Occurring Items*). Discontinued operations and the cumulative effects of changes in accounting principles are also excluded from ordinary income (or loss).

Significant unusual or infrequently occurring items are reported as discrete events (i.e., not included in the annual effective tax rate) if they reflect transactions that are separately reported or reported net of the related tax effects (e.g., discontinued operations). In addition to being unusual or infrequently occurring, a transaction also must be significant to be excluded from ordinary income (and, therefore, excluded from the effective tax rate calculation). Significance generally does not, in and of itself, allow for a transaction to be recognized discretely.

Companies affected by the COVID-19 pandemic and current market conditions may be recognizing goodwill or long-lived asset impairment charges or entering (or expecting to enter) into transactions to modify leases, loans or other contracts. Deciding whether significant events should be considered unusual or infrequently occurring items can be challenging. Determining whether a transaction should be classified as an unusual or infrequently occurring item requires careful consideration of the facts and circumstances as well as expectations about the future.

In some instances, an event may not be infrequent or unusual but may change the ordinary income projections so significantly that it calls into question a company's ability to estimate its ordinary income. See the following section for discussion when a company does not have the ability to estimate its ordinary income.

### Determining estimated annual effective tax rate for an interim period

Under ASC 740, each interim period is considered an integral part of the annual period, and the tax expense is measured using an estimated annual effective rate. A company is required, at the end of each interim reporting period, to make its best estimate of the annual effective tax rate for the full fiscal year and use that rate to provide for income taxes on a current year-to-date basis. The estimated effective tax rate should reflect enacted federal, state and local income tax rates; foreign tax rates and credits; percentage depletion; capital gains rates; other taxes and credits; and available tax-planning alternatives. The rate should be revised, if necessary, as of the end of each successive interim period during the fiscal year to the entity's best current estimate of its annual effective tax rate.

Companies affected by the COVID-19 pandemic may experience a reduction in demand, temporary closures of their operations or supply chain interruptions that may create challenges in preparing reliable estimates. Estimates of the annual effective tax rate are, of necessity, based on evaluations of possible future events and transactions, and may be subject to refinement or revision.

ASC 740 addresses the consequences of an entity's inability to reliably estimate some or all the information that is ordinarily required to determine the annual effective tax rate in an interim period financial statement. When an entity is unable to estimate a part of its ordinary income (loss) or the related tax expense (benefit) but is able to make a reliable estimate of its estimated annual effective tax rate, the tax expense (benefit) applicable to the item that cannot be estimated should be reported in the interim period in which the item is reported.

In some cases, a company may not be able to make a reliable estimate of its estimated annual effective tax rate (e.g., when minor changes in estimated ordinary income could have a significant effect on the estimated effective tax rate). This could occur when a company's operating results will be at or near break-even or when permanent differences are significant compared to estimated income. If a reliable estimate of the estimated annual effective tax rate cannot be made, the actual effective tax rate for the year to date may be the best estimate of the annual effective tax rate.

In addition, when there is a significant variation in the customary relationship between income tax expense and pretax income in the interim period financial statements, a company should disclose the reasons in its interim financial statements if they are not otherwise apparent from the financial statements or from the nature of the entity's business.

### How we see it

We generally expect a company to be able to make a reliable estimate of ordinary income and an estimated annual effective tax rate. However, due to challenges relating to current market conditions, a company may not have the ability to make a reliable estimate of all or part of its ordinary income. We believe that a company's conclusion that it cannot make a reliable estimate of all or parts of its ordinary income or its estimated annual effective tax rate should be consistent with conclusions reached about similar projections used by management in the financial statements and disclosures made to users of the financial statements.

#### Companies with operations in multiple jurisdictions

A company that has operations in multiple jurisdictions may be experiencing losses in certain jurisdictions due to the current market conditions. Generally, ASC 740 requires an entity that is subject to tax in multiple jurisdictions to determine one overall estimated annual effective rate to calculate the interim period tax expense (benefit). However, there are two exceptions to this requirement:

- ▶ If, in a separate jurisdiction, the company anticipates an ordinary loss for the fiscal year or incurs an ordinary loss for the year-to-date period for which a tax benefit cannot be realized, the company should exclude the ordinary income (loss) in that jurisdiction and the related tax (benefit) from the overall computations of the estimated annual effective tax rate and interim period tax (benefit). The company must compute a separate estimated annual effective tax rate for this jurisdiction, which would be applied to the ordinary income (loss) in that jurisdiction.
- ▶ If a company is unable to estimate the annual effective tax rate in a foreign jurisdiction in dollars or is otherwise unable to make a reliable estimate of the ordinary income (loss) or the related tax (benefit) in a foreign jurisdiction for the fiscal year, the company should exclude the ordinary income (loss) in that jurisdiction and the related tax (benefit) from the overall computations of the estimated annual effective tax rate and interim period tax (benefit). The company must compute separately the interim tax (benefit) in this jurisdiction as the jurisdiction reports ordinary income (loss) in an interim period.

#### Companies with year-to-date ordinary losses in an interim period

Affected companies may have unexpected ordinary losses and will need to determine whether they will be able to benefit from those losses when computing their estimated annual effective tax rate. In addition, when a company has a year-to-date ordinary loss that exceeds the anticipated ordinary loss for the fiscal year, ASC 740 limits the income tax benefit recognized for the year-to-date interim period to the amount that would be recognized if the year-to-date ordinary loss were the anticipated ordinary loss for the fiscal year.

This limitation does not apply to companies that have early adopted ASU 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*, which eliminates this exception in ASC 740. Under the new guidance, a company would no longer limit the tax benefit recognized in an interim period if it expects to realize a tax benefit.

For more information about the income tax accounting and disclosure implications of the relief provided by the CARES Act and the market conditions related to the COVID-19 pandemic, refer to our Technical Line, [\*\*Accounting for the income tax effects of the CARES Act and the COVID-19 pandemic.\*\*](#)

Please also refer to our FRD, [\*\*Income taxes\*\*](#), for additional information.

#### **Government assistance (updated 4 June 2020)**

Governments around the world continue to consider measures to help companies deal with the economic fallout of the COVID-19 pandemic. Measures already enacted include providing loan guarantees or loans at below-market interest rates, grants, tax relief and paying for medical services (e.g., diagnostic testing for COVID-19). To receive certain loans and other relief, companies may be required to agree to certain conditions.

## How we see it

An entity's accounting for and disclosures about government assistance depend on the type of government assistance it receives. Legislation providing assistance may use terms such as "grant" or "credit" to describe the form of the assistance, but entities will need to carefully evaluate the substance of the legislation to determine the appropriate accounting.

The accounting and disclosure implications (e.g., timing of recognition, financial statement presentation) would vary significantly, for example, depending on whether the assistance is considered a loan, a grant, a payment for goods or services, a contribution or an income tax credit.

There is no US GAAP guidance for for-profit business entities that receive government grants that are not in the form of a loan, an income tax credit or revenue from a contract with a customer. As such, business entities will need to determine the appropriate accounting treatment by analogy to other guidance. When the assistance received is in the form of a government grant and is not an income tax credit or loan and does not represent revenue, we generally believe that business entities should account for it by analogy to International Accounting Standards (IAS) 20, *Accounting for Government Grants and Disclosure of Government Assistance*, of International Financial Reporting Standards (IFRS). However, analogies to other guidance, such as ASC 958-605 for contributions received by not-for-profits or ASC 450-30 for gain contingencies, also may be appropriate. A not-for-profit entity that receives a government grant should apply ASC 958-605.

### ***Determining whether government assistance relates to income taxes***

We generally believe that an entity that receives government assistance in the form of an income tax credit should account for the assistance in accordance with ASC 740.

ASC 740 applies to all federal, foreign, state and local (including franchise) taxes based on income. That is, any tax levied on (or credited to) an entity based on the entity's income (or income tax liability) is generally subject to the provisions of ASC 740. A credit from a government entity that isn't based on taxable income would generally be considered a government grant and would, therefore, be out of the scope of ASC 740. Refer to section 4.2.8 of our FRD, [\*\*Income taxes\*\*](#), for additional information on the accounting for government assistance that is in the scope of ASC 740.

### ***Determining whether government assistance represents revenue from a customer***

An entity receiving assistance from a governmental entity must consider whether the payment represents revenue under ASC 606, if the government entity making the payment also is a customer of the entity. An entity with an existing contract with the government entity should evaluate whether the assistance is a modification of the contract under ASC 606. If an entity does not have an existing contract with the government entity, then the guidance in ASC 958-605<sup>6</sup> may help the entity determine whether individual asset transfers are contributions, exchange transactions (to be accounted for under ASC 606, for example) or a combination of both.

An entity receiving assistance from a government entity will need to consider the facts and circumstances when determining how to characterize any payment received in its financial statements.

Companies that receive government assistance need to carefully consider the type of assistance to determine the appropriate accounting treatment.

We further believe that an entity might consider the following factors when making this determination:

- ▶ Whether a commercial purpose exists for the payments (e.g., whether other customers of the entity might make similar payments)
- ▶ Whether the required activity to qualify for the assistance relates to the entity's ongoing revenue-generating activities (e.g., whether the entity is required to provide a good or service it provides to its other customers; whether the required activity relates to particular operational aspects of the business, such as the maintenance of a production plant used to manufacture the products sold to customers)

#### ***Accounting for a government grant***

As stated above, if a business entity determines that the government assistance it receives is not revenue, a loan or an income tax credit, it will have to analogize to other guidance. We generally believe that a business entity should account for government assistance as a government grant by analogy to IAS 20. However, analogies to other guidance, such as ASC 958-605 for contributions received by not-for-profits or ASC 450-30 for gain contingencies, also may be appropriate. A not-for-profit entity that receives a government grant should apply ASC 958-605.

Before selecting an accounting policy, a business entity should consider whether it has a pre-existing policy for similar grants. If not, it should consider the facts and circumstances associated with the grant and which accounting model would best reflect the nature and substance of the grant. Regardless of the accounting model it applies, a business entity should adequately disclose its accounting policy for such grants and their impact on the financial statements.

#### ***Recognition and measurement overview under IAS 20***

Generally, government grants fall into two categories: grants related to assets and grants related to income. The type of grant an entity receives will determine how it presents the grant in its financial statements. Grants related to assets are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets. IAS 20 defines grants related to income as all grants other than those related to assets.

An entity may receive a grant as part of a package of financial or fiscal aid to which a number of conditions are attached. In these cases, the entity may need to exercise judgment to determine whether the criteria for recognizing the grant have been met. Further, grants could have clawback provisions that require the entity to repay the grant if certain conditions are not satisfied. An entity would need to carefully consider these provisions.

Government grants are recognized when there is reasonable assurance that the grant will be received and the entity will comply with any conditions attached to the grant. However, once this threshold is met, an entity doesn't necessarily recognize the entire grant as income.

Grants should be recognized in income on a systematic and rational basis over the periods in which the entity recognizes as expenses the costs the grants are intended to defray. For example, grants and subsidies intended to reimburse expenses incurred or to supplement sales proceeds are credited in the period in which the expenses or sales are recorded. Grants and subsidies received to defray future expenses (e.g., salaries of a new labor force) or to supplement future sales revenues are deferred and recognized in proportion to the expenses or sales to which they relate.

The method of income recognition also should consider any conditions and clawback provisions. For example, immediate income recognition of grants solely based on cash receipts would only be appropriate if no basis exists for allocating the grant to periods other than the one in which it was received or if it is specifically for expenses already incurred and there are no repayment or clawback provisions.

To determine the timing and pattern of recognition, companies should carefully evaluate the substance of the government assistance arrangement and the conditions attached to the grant. Additionally, companies should adopt a method that is consistently applied to similar fact patterns.

#### *Recognition of grants related to assets under IAS 20*

IAS 20 indicates that grants related to assets should be presented in the balance sheet using one of two methods. Under the first method, the grants are recorded as deferred income when they are received. The deferred income is then recognized as grant income over the useful life of the related asset(s), which is frequently the period of depreciation for the related asset, although other periods may also be appropriate.

Under the second method, the funds received are deducted from the carrying amount of the related asset. This results in the qualifying asset being recorded at a lower amount and, therefore, a reduction of depreciation over the life of the asset.

The choice of a method isn't expected to result in fundamentally different income statement effects. However, we understand that it is more common to account for the assistance received as a deduction from the carrying amount of the asset.

#### *Recognition of grants related to income under IAS 20*

IAS 20 provides that grants related to income can be presented in one of two ways:

- ▶ A credit in the income statement, either separately or under a general heading, such as "other income"
- ▶ A reduction to the related expense

These types of grants are recognized in the income statement beginning in the period that the recognition criteria are met, which will likely depend on the conditions of the grant. In many cases, the appropriate method to recognize the grant in income will be apparent. For example, grants and subsidies to reimburse expenses incurred or to supplement sales proceeds are credited in the period in which the expenses or sales are recorded. Grants and subsidies received to defray future expenses (e.g., salaries of a new labor force) or to supplement future sales revenues are deferred and recognized in proportion to the expenses or sales to which they relate.

Companies should carefully evaluate the substance of the government assistance arrangement and the conditions attached to the grant (e.g., clawback provisions). Additionally, companies should adopt a method that is consistently applied to similar fact patterns.

#### ***Paycheck Protection Program***

The CARES Act created the Paycheck Protection Program (PPP) to provide certain small businesses with liquidity to support their operations during the COVID-19 pandemic. Entities have to meet certain eligibility requirements to receive PPP loans, and they must maintain specified levels of payroll and employment to have the loans forgiven. The conditions are subject to audit by the US government. However, as noted in the Frequently Asked Questions issued by the US Small Business Administration (SBA), entities that borrow less than \$2 million (together with any affiliates) will be deemed to have made the required certification concerning the necessity of the loan in good faith.

Because the legal form of a PPP loan is debt, it is acceptable for an entity that receives such a loan to account for it as debt under ASC 470, regardless of whether the entity expects the loan to be forgiven. However, an entity that expects to meet the PPP's eligibility and loan forgiveness criteria may elect to account for the proceeds as akin to a government grant related to income (as discussed above). An entity that does not expect to meet the PPP eligibility and loan forgiveness criteria must account for the proceeds as debt.

Entities that receive PPP loans should monitor developments because the SBA is expected to provide more guidance to address questions about the program. See our Technical Line, [\*\*How to account for proceeds from Paycheck Protection Program loans\*\*](#), for further discussion.

### ***Employee Retention Credit***

The ERC, created by the CARES Act, is designed to encourage entities to keep employees on their payroll despite experiencing economic hardship due to the COVID-19 pandemic. An entity is eligible for the ERC if it has not received a PPP loan and (1) its operations have been fully or partially suspended because of COVID-19 or (2) its gross receipts in a calendar quarter in 2020 declined by more than 50% from the same period in 2019.

Under this program, an eligible entity may take a credit against the employer portion of Social Security taxes withheld on qualified wages. Qualifying wages include wages, certain compensation and certain health plan expenses and are defined by the average number of employees the entity had in 2019.

The credit is limited to 50% of up to \$10,000 of qualified wages paid to each employee between 13 March and 31 December 2020. Under this program, an entity can also receive an advance payment if the anticipated credit exceeds the amount of the entity's employment tax deposits.

As with other forms of government assistance provided under the CARES Act, entities will need to consider the accounting and financial reporting implications of their participation in this program. Because the assistance received is not an income tax credit in the scope of ASC 740, we believe it would be acceptable for a business entity to account for the credit as a government grant by analogy to IAS 20 (as discussed above). A not-for-profit entity that receives a government grant should apply ASC 958-605.

Under an IAS 20 analogy, a business entity would recognize the credit on a systematic basis over the periods in which the entity recognizes the payroll expenses for which the grant is intended to compensate when there is reasonable assurance (i.e., it is probable) that the entity will comply with conditions and the grant (i.e., tax credit) will be received. As also discussed above, IAS 20 permits presentation as a credit in the income statement or as a reduction of the related expense. Entities will need to evaluate their facts and circumstances to determine which presentation is most transparent to users of the financial statements.

### ***Disclosure related to government assistance***

The appropriate financial statement disclosure of the government assistance depends on which accounting standards are applied. If the amount of government assistance received is material, the method of accounting for the assistance should be included in the disclosure of accounting policies. A company may also consider disclosing a description of the nature and extent of the grants recognized, the amount included in income or deferred, the basis for recognizing deferred amounts, the terms and conditions of the grants and any unfulfilled conditions, and contingent liability for repayment. If benefits are recognized in income as received, the entity might disclose how long it expects the benefits to continue, if the amounts are material.

### **Bankruptcy and liquidation (added 4 June 2020)**

Due to the economic fallout from the COVID-19 pandemic, some entities may enter into bankruptcy proceedings under Chapter 11. ASC 852, *Bankruptcies and Liquidations*, provides accounting and financial reporting guidance for both entities that are reorganizing under Chapter 11 and those that are emerging from Chapter 11 proceedings. If an entity decides to liquidate (under Chapter 7 bankruptcy or otherwise) and liquidation is imminent, as defined in US GAAP, the liquidation basis of accounting is required. Refer to our FRD, [\*Bankruptcies, liquidations and quasi-reorganizations\*](#), for additional information.

### **Consolidation (added 31 March 2020)**

In response to the COVID-19 pandemic and economic fallout, legal entities with which an entity is involved may restructure their operations in ways that change their purpose and design and/or recapitalize, change their governance structure or obtain additional financial support necessary to address current or anticipated liquidity needs. Reporting entities should carefully evaluate any actions that could affect their rights associated with governance matters of a legal entity or create additional exposure to risk of loss (e.g., investing equity, purchasing assets at more than fair value, providing letters of credit, making loans, issuing guarantees, waiving fees, eliminating dividends).

Reporting entities are required to reevaluate whether a legal entity is a variable interest entity (VIE) when certain significant events occur that change the design of that legal entity or call into question whether (1) the legal entity's equity investment at risk is sufficient or (2) the holders of the legal entity's equity investment at risk, as a group, have the characteristics of a controlling financial interest. In addition, a reporting entity is required to continuously evaluate whether it is the primary beneficiary of a VIE as a result of changes in facts and circumstances. Reporting entities also need to consider whether their actions create new variable interests, including implicit variable interests, or change their previous conclusions, including whether the fees they receive are variable interests.

It is possible that a reporting entity's actions, or changes in facts and circumstances related to a legal entity with which it is involved, could change consolidation conclusions, and judgment needs to be applied carefully. See section 12 of our FRD, [\*Consolidation\*](#), for additional guidance on reconsideration events and the VIE model in ASC 810, *Consolidation*.

### **Financial statement disclosures (updated 4 June 2020)**

An affected company's disclosures will depend on the magnitude, duration and nature of the effects on its business. Companies will need to closely monitor developments and assess the implications for their businesses.

Affected companies will be required to make disclosures that generally address loss contingencies, risks and uncertainties, and/or subsequent events. In other cases, disclosures may depend on the nature of the loss (e.g., whether an asset is impaired).

When an impairment was triggered by events related to the COVID-19 pandemic, companies should disclose the facts and circumstances leading to impairment. Further, companies should be transparent about all circumstances that contributed to the impairment or loss when there were circumstances other than COVID-19 that contributed to the impairment.

ASC 450 requires disclosure of the nature of a contingency when there is at least a reasonable possibility that a loss has been incurred.

### Loss contingencies

ASC 450 requires disclosure of the nature of a contingency when there is at least a reasonable possibility that a loss has been incurred. For contingencies that meet the threshold for disclosure but no liability has been recognized, companies must disclose an estimate of the possible loss or the range of possible losses or state that such an estimate cannot be made. If a company has recognized a liability, it has to disclose the amount only if not doing so would make the financial statements misleading. If there is at least a reasonable possibility that a loss in excess of the amount recognized exists, the company is required to disclose an estimate of the possible loss or range of losses or state that such an estimate cannot be made.

Loss contingency disclosures have been an area of focus for the SEC staff. The SEC staff focuses on disclosures about reasonably possible losses and the clarity and timeliness of loss contingency disclosures.

Specifically, the SEC staff has questioned a company's failure to make required footnote disclosures when losses are considered reasonably possible of occurring or to disclose the range of reasonably possible losses, including when there is a reasonable possibility of a loss in excess of the amount accrued. Companies should consider whether any contingent loss resulting from the pandemic is reasonably possible and make disclosures as appropriate.

### Risks and uncertainties

ASC 275 requires disclosures about certain risks and uncertainties. They include qualitative disclosures about risks and uncertainties that in the near term (i.e., within one year from the date of the financial statements) could significantly affect the amounts reported in the financial statements or the functioning of the reporting entity. Companies whose operations are affected by the pandemic may be required under ASC 275 to disclose certain significant estimates and current vulnerability due to concentrations (e.g., concentration in the volume of business with a particular customer or supplier or in a market or geographic area).

#### *Certain significant estimates*

Companies should disclose certain estimates that are sensitive to change, such as those used to evaluate an asset for impairment if information known to management before the financial statements are issued or available to be issued meets both of the following criteria:

- It is at least reasonably possible that management's estimate of the effect on the financial statements of a condition, situation or set of circumstances existing at the date of the financial statements will change in the near term as a result of one or more future confirming events.
- The effect of the change would be material to the financial statements.

The objective of this disclosure is to provide an early warning signal regarding the possibility that certain estimates made by management in preparing the financial statements may change in the near term. Public companies have similar responsibility under SEC requirements to discuss in MD&A known trends or uncertainties that may make historical financial information not indicative of future operations or financial condition.

For uncertainties that meet both of ASC 275's criteria for disclosure, entities are required to state the nature of the contingency or estimate that is sensitive to change and indicate that it is reasonably possible that a change in the estimate will occur in the near term. Additionally, ASC 275 encourages, but does not require, disclosure of the factors that cause an estimate to be sensitive to material change.

If an entity uses risk-reduction techniques, such as obtaining insurance to mitigate risks related to uncertainties, ASC 275 encourages, but does not require, disclosure of the uncertainty along with the risk-reduction strategy.

#### ***Current vulnerability due to certain concentrations***

Companies with concentrations face greater risk of loss than other companies. ASC 275 requires the disclosure of certain concentrations, as described in ASC 275-10-50-18, if, based on information known to management before the financial statements are issued or available to be issued, all three of the following criteria are met:

- ▶ The concentration exists at the date of the financial statements.
- ▶ The concentration makes the entity vulnerable to the risk of a near-term “severe impact.”
- ▶ It is at least reasonably possible that the events that could cause the severe impact will occur in the near term.

Companies that have identified concentrations of activities in areas affected by the pandemic (e.g., a high volume of business with customers in that region or key suppliers in that region) that have not previously disclosed the concentration because they did not believe that the company was vulnerable to the risk of a near-term severe impact should reconsider making such a disclosure.

When the criteria for disclosure are met, a company should provide information that is adequate to inform users of the financial statements of the general nature of the risks or uncertainties associated with the concentration. For concentrations of operations located outside of the entity’s home country, an entity is required to disclose both the carrying amount of net assets and the geographic areas in which they are located.

#### **Going concern**

ASC 205-40, *Presentation of Financial Statements – Going Concern*, requires management to evaluate an entity’s ability to continue as a going concern within one year after the date the financial statements are issued (or available to be issued, when applicable). Disclosures in the notes to the financial statements are required if management concludes that substantial doubt exists or that its plans alleviate that substantial doubt. Management is required to make its evaluation and provide the relevant disclosures for both annual and interim reporting periods.

Affected companies will need to consider the effects of the pandemic in their going concern evaluations. For example, prolonged plant closures or significant delays or the inability to collect from counterparties whose businesses are severely affected by the pandemic may significantly affect a company’s operating cash flow and liquidity. Accordingly, management may need to update the cash flow projections it uses in its going concern evaluation.

#### **Subsequent events**

Companies should evaluate whether an event related to the pandemic (e.g., bankruptcy of a customer) provides additional evidence about conditions that existed at the balance sheet date, including the estimates used to prepare financial statements. All information that becomes available before the financial statements are issued or available to be issued should be considered in the evaluation of the conditions on which financial statement estimates are based, because these events typically represent the culmination of conditions that existed over a relatively long period and, most importantly, existed before the balance sheet date. The financial statements should be adjusted for any changes in estimates resulting from such recognized subsequent events.

The rate of spread of COVID-19 after the balance sheet date may not provide additional evidence about conditions that existed at the balance sheet date. Judgment may be required to evaluate certain events that occurred after the balance sheet date to appropriately distinguish between the COVID-19 pandemic and other conditions that may have existed at the balance sheet date. For example, a customer bankruptcy that occurred after the balance sheet date may be attributable to factors that are unrelated to the COVID-19 pandemic.

For pandemic-related events that do not provide additional evidence about conditions that existed at the balance sheet date, affected companies should consider disclosing the nature of the event and an estimate of its effect on the financial statements, or a statement that such an estimate cannot be made. Additionally, companies that may be indirectly affected by the event, such as a company with a concentration of revenue from customers in an affected region, should consider whether subsequent event disclosures are necessary to keep the financial statements from being misleading.

## SEC reporting and disclosures (updated 4 June 2020)

Domestic and foreign companies that file with the SEC need to consider a number of SEC reporting and disclosure requirements.

SEC Chairman Jay Clayton has said that companies should have robust controls and procedures so they can timely disclose material information and events related to COVID-19 and identify triggering events that may warrant the filing of a Form 8-K. Clayton and Division of Corporation Finance Director William Hinman have emphasized that high-quality disclosures will benefit both investors trying to make decisions and companies by allowing the market to digest important information about the effects of COVID-19.

The SEC's Division of Corporation Finance issued **Disclosure Guidance Topic No. 9, Coronavirus (COVID-19)**, which provides the SEC staff's views on disclosure and other securities law obligations that registrants should consider with respect to COVID-19 and its effects on their operations and financial condition. The guidance provides questions on a wide range of topics that registrants can use to develop disclosures about the effects of COVID-19 to satisfy various disclosure obligations. See our To the Point, **SEC extends relief and issues staff guidance on COVID-19 disclosures**, for more information on the guidance.

Chairman Clayton and Mr. Hinman also encouraged companies to provide appropriately framed forward-looking information and take advantage of the safe-harbor liability protections provided by the Securities Act and the Exchange Act. Because historical information may be less relevant in today's climate, a company should consider providing robust discussions about where it stands today, operationally and financially; how its COVID-19 response is progressing; and how its operations and financial condition may change as efforts to fight COVID-19 progress, they said.

### MD&A

When discussing the results of operations for the period, affected companies should disclose any unusual or infrequent events, transactions or any significant economic changes that materially affected income from continuing operations (such as lost revenue or costs attributable to the COVID-19 pandemic).

Companies are also required to disclose known trends or uncertainties that have had, or are reasonably expected to have, a material effect on the registrant's revenue or income from continuing operations, liquidity or capital resources.<sup>7</sup> For example, many companies have experienced a drop in demand and have had to cut prices for their products or services. Companies have also experienced supply chain disruptions that may affect the relationship of

costs to revenues. Companies should consider quantifying these effects to the extent determinable. The level and nature of the disclosure will depend on a company's facts and circumstances, including the implications for its operations, liquidity and financial condition.

Companies may also need to consider effects on their capital resources and liquidity, including situations in which the sources and uses of cash could be materially affected and potentially lead to uncertainty about a company's ability to continue to meet covenants of credit agreements. A company that is having liquidity issues should evaluate the adequacy of its disclosures related to potential capital needs and alternative sources of capital to fund those needs, including the nature, amounts and effects of any government assistance. If a material liquidity deficiency has been identified, disclosures may need to include the course of action that the company has taken or proposed to take to remedy the deficiency.

It may also be appropriate for companies to include disclosures in MD&A related to any heightened uncertainty associated with key assumptions underlying critical accounting estimates.

### **Risk factor disclosures**

A registrant is required to disclose in each quarterly report on Form 10-Q any material new risks or changes in risk factors previously disclosed in its annual report on Form 10-K. Accordingly, risk factors that were added or revised in the first quarter would need to be disclosed and updated as appropriate in each subsequent quarterly report if they are still applicable.

### **Non-GAAP financial measures**

The SEC staff provided a limited accommodation related to non-GAAP measures for registrants facing difficulties reporting financial results due to the pandemic. Under the accommodation, a registrant can reconcile a non-GAAP measure presented in connection with an earnings release to a GAAP measure that includes a provisional amount related to an item or a range of results if it makes specified disclosures.

Companies should be mindful of Item 10(e) of Regulation S-K, Regulation G and SEC staff Compliance and Disclosure Interpretations when presenting any non-GAAP financial measures that adjust for any items related to COVID-19.

We believe registrants that want to explain the effects of COVID-19 should limit adjustments in their non-GAAP measures to charges incurred or gains recognized that clearly relate to COVID-19 and are incremental to, and separable from, normal operations. Evaluating whether adjustments meet these criteria may require significant judgment.

For example, franchisees and retail chains may incur lease-termination fees and other store-closure costs as part of their normal operations. A retailer that experiences significantly higher lease-termination fees because it is closing more stores during the COVID-19 pandemic should not exclude these costs from its non-GAAP measures unless it can demonstrate that such charges are not part of normal operations.

As always, registrants should explain why such measures are useful to investors and consider whether they are consistent with measures used by management and communicated to the board. It would generally be inappropriate to disclose a non-GAAP measure of operating performance that normalizes operations (e.g., by adding to net income an estimate of revenues lost as a result of the pandemic) or eliminates normal recurring cash operating expenses.

A registrant can nevertheless describe and quantify the effects of the pandemic (including those that would otherwise be prohibited non-GAAP adjustments) in one place by listing those effects separately without adjusting its GAAP results. For example, this could be done in a supplemental table that describes each item and includes dollar amounts. While the non-GAAP

rules and related SEC staff guidance would not apply to such supplemental information, a registrant that presents such a table should consider explaining how and why it can help investors analyze the registrant's results.

See our Technical Line, [\*\*\*How to appropriately use non-GAAP measures to discuss the effects of COVID-19\*\*\*](#), for FAQs about the SEC staff accommodation and COVID-19-related non-GAAP adjustments.

### **Other disclosure considerations**

Affected companies should consider the effects of the pandemic on their reporting obligations on Form 8-K. For example, a company that performs interim impairment tests that result in impairment charges because of a business interruption or the decline in economic activity should consider whether the impairment charge is material, which generally would require reporting within four business days under Item 2.06 of Form 8-K.<sup>8</sup> Companies should also consider whether any costs related to ceasing operations should be reported under Item 2.05 of Form 8-K and whether any liquidity issues trigger the violation of debt covenants or the acceleration of obligations that would have to be reported under Item 2.04 of Form 8-K.

Companies may also need to consider updating their other disclosures for the effects of the COVID-19 pandemic when filing their annual reports or registration statements, including the descriptions of their business and properties under Items 101 and 102 of Regulation S-K, respectively.

### **SEC filing relief**

The SEC issued an order extending the temporary 45-day grace period for companies affected by the COVID-19 pandemic to file Exchange Act reports (e.g., Forms 10-K and 10-Q) to include those due on or before 1 July 2020. The SEC staff further clarified that a registrant may use this grace period to extend the deadline for filing or incorporating by reference certain proxy statement information into Part III of its Form 10-K.

To rely on the temporary relief, a company must file a Form 8-K or Form 6-K (for a foreign private issuer) by the original report deadline that includes, among other things, a summary of why the relief is needed for each Exchange Act report that is delayed. When it files the delayed report, the registrant must also disclose that it relied on the order and include its reasons for not filing timely.

The SEC staff clarified that filing a Form 12b-25 does not meet the conditions required to obtain a 45-day extension under the SEC relief order. A registrant that files a Form 12b-25 without filing the required Form 8-K obtains only a 15-day grace period for filing a Form 10-K or a five-day grace period for filing a Form 10-Q, not the 45-day extension allowed by the relief order. However, a registrant that obtains the order's 45-day extension by filing a Form 8-K may subsequently rely on Rule 12b-25 to receive an additional grace period by filing a Form 12b-25 to notify the SEC of its inability to file the report by the extended due date.

If the reason the report cannot be filed timely relates to the inability of another person, other than the registrant, to furnish an opinion or report, the Form 8-K or Form 6-K must include a statement signed by that person as an exhibit, similar to the requirements of Rule 12b-25(c).

The SEC staff also issued [\*\*COVID-19 Related FAQs\*\*](#) to address questions regarding the use of Form S-3 by registrants that cannot file their periodic reports on time due to the COVID-19 pandemic. The FAQs clarify that registrants that validly rely on the relief order can continue to conduct takedowns using an already-effective Form S-3 registration statement during the extension period but must reassess their Form S-3 eligibility upon filing a Form 10-K, which may be by an extended due date. Registrants can also file a new Form S-3 registration

A registrant is required to disclose that it relied on the SEC order and its reasons for not filing timely in its delayed report on Forms 10-K or 10-Q, in addition to disclosing this information in its original Form 8-K that reported the delay.

statement before the extended due date of a periodic report, but the SEC staff will be unlikely to accelerate its effective date until all required information is filed. Similarly, a registrant will also retain its Form S-8 eligibility and meet the current public information eligibility requirements of Rule 144(c) if it makes its filings by the extended due date.

### How we see it

Based on our review of Form 8-K and Form 6-K filings explaining why registrants need relief, common reasons include challenges in evaluating certain assets for impairment due to uncertainty in the outlook for the business and difficulty completing normal closing processes due to a reduced or dispersed workforce.

### Other SEC reporting matters

The SEC staff recently provided guidance to assist issuers, shareholders and other market participants with meeting their obligations under the federal proxy rules in light of the spread of COVID-19.

Under the staff guidance, issuers can conduct “virtual” or “hybrid” annual meetings that allow remote participation. An issuer that has already mailed and filed its proxy materials would not be required to mail additional soliciting materials or amend its proxy materials if certain conditions are met. The staff expects issuers that are planning to conduct a “virtual” or “hybrid” meeting to timely notify their shareholders and other market participants and provide clear instructions on how to participate.

The guidance encourages issuers to permit proponents of shareholder proposals to make presentations using alternative means, such as by phone, if they cannot attend in person.

The SEC staff also issued a **statement** regarding Rule 302(b) of Regulation S-T, which requires each signatory to manually sign a signature page or other document that appears in typed form in documents filed electronically with the SEC. Due to the COVID-19 pandemic, the SEC staff said it will not recommend that the SEC take enforcement action related to the inability to comply with this requirement if certain conditions are met.

### ICFR considerations (added 31 March 2020)

Companies will also need to consider how the COVID-19 pandemic may be affecting ICFR. Disruptions to a company’s operations, processes, workforce, customers and suppliers should be considered in evaluating whether legacy controls continue to be designed and operating at an appropriate level to mitigate risks of material misstatement to the financial statements. If a control cannot be performed as previously designed, a company needs to make sure any changes in design address the original risks of material misstatement and any new or modified risks.

Companies also may need to consider whether they need to design and operate any new controls over processes, such as a going concern assessment, that may not have required in-depth analysis in the past. Making such an assessment in the current environment, given the uncertainty, may require a company to perform a more detailed analysis and estimation process than it has in the past.

In the current environment, companies may also need to consider whether they are able to collect all of the information they need and retain evidence that their controls are operating effectively. For example, companies with significant operations in affected regions may experience difficulty in obtaining financial information that is subject to the same controls that existed prior to the pandemic. Companies will need to determine how this affects the operation of controls over their financial statement close process (FSCP) and whether controls need to be redesigned to address the risks of material misstatement in the FSCP process.

We expect that accounts affected by estimation processes will need close evaluation on an interim basis. Depending on the business and industry, some of these estimation processes may be based on data that is highly subjective or likely to dramatically change in the future. Companies will need to conduct a robust and thoughtful evaluation process to make sure they have appropriate internal controls in place to adequately identify and evaluate known facts and circumstances when developing their estimates.

A good starting point for making estimates in the current environment is an existing process, appropriately modified for any changes in the design of controls. The operation of estimation process controls will likely need to consider new inputs and assumptions in connection with challenges caused by the COVID-19 pandemic. Given the significant disruptions to business activity in several industries and the uncertainty about the duration of these disruptions, companies will need to focus on controls to determine the completeness and accuracy of relevant, available information to make estimates. Historical tolerances or sensitivities in internal controls may need to be revised to address changes in the current environment, and contrary evidence will need to be considered.

Companies will also need to make sure their disclosure controls are operating effectively so they can produce thoughtful and robust disclosures. SEC registrants need to consider whether they have made any changes to the design of their ICFR that has materially affected, or is reasonably likely to materially affect, their ICFR and would, therefore, need to be disclosed in Form 10-Q or Form 10-K. Controls that now operate virtually and are performed by people who work from home may adversely affect a company's ability to maintain operations, including financial reporting systems, ICFR and disclosure controls and procedures. Determining what constitutes a material or reasonably likely material change in a control during the current period will require careful consideration.

Finally, companies should hold timely discussions with their audit committees and auditors to make sure their financial reporting and review processes are robust and practical, considering the circumstances.

#### Endnotes:

- <sup>1</sup> ASC 310-40-15-17 states that a delay in payment that is insignificant is not a concession. As such, providing a short-term extension of payment terms would generally not be considered a troubled debt restructuring.
- <sup>2</sup> ASC 842-20-50-1 (lessee disclosure objective); ASC 842-30-50-1 (lessor disclosure objective).
- <sup>3</sup> Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus
- <sup>4</sup> See FASB Statement on Prudential Regulator Guidance Concerning Troubled Debt Restructurings
- <sup>5</sup> "Probable" is defined in the ASC Master Glossary as "the future event or events are likely to occur."
- <sup>6</sup> ASC 958-605-55-4 through 55-7 and ASC 958-605-55-13A through 55-14I.
- <sup>7</sup> Item 303 of Regulation S-K.
- <sup>8</sup> No filing is required under Item 2.06 of Form 8-K as long as (1) the conclusion is made in connection with the preparation, review or audit of financial statements required to be included in the next periodic report due to be filed under the Exchange Act, (2) the periodic report is filed on a timely basis and (3) the conclusion is disclosed in the report.

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## Appendix

This appendix highlights and provides links to FRDs, To the Points and Technical Lines referenced throughout this publication. See below for the breakout by section.

### Overview

- ▶ Technical Line, [Accounting considerations related to recent declines in oil and gas prices](#)
- ▶ Technical Line, [Lessee accounting considerations for retailers in the current environment](#)
- ▶ To the Point, [Relief provided by the CARES Act will affect accounting and financial reporting](#)

### Asset impairments

- ▶ Technical Line, [Accounting for impairment of goodwill and indefinite-lived intangible assets due to the coronavirus](#)
- ▶ Financial reporting developments, [Impairment or disposal of long-lived assets](#)
- ▶ SEC financial reporting series, [2020 SEC quarterly reports – Form 10-Q](#)
- ▶ Financial reporting developments, [Intangibles – goodwill and other](#)
- ▶ Financial reporting developments, [Equity method investments and joint ventures](#)
- ▶ Financial reporting developments, [Certain investments in debt and equity securities \(after the adoption of ASU 2016-01\)](#)
- ▶ Financial reporting developments, [Credit impairment under ASC 326](#)
- ▶ Financial reporting developments, [Credit impairment for short-term receivables under ASC 326](#)

### Leases

- ▶ Technical Line, [Accounting for rent concessions related to the COVID-19 pandemic under ASC 842](#)
- ▶ Financial reporting developments, [Lease accounting \(ASC 842\)](#)
- ▶ Financial reporting developments, [Lease accounting \(ASC 840\) before the adoption of ASC 842](#)

### Exit or disposal activities

- ▶ Financial reporting developments, [Exit or disposal cost obligations](#)

### Fair value measurement

- ▶ Financial reporting developments, [Fair value measurement](#)

### Derivatives and hedge accounting

- ▶ Financial reporting developments, [Derivatives and hedging \(after the adoption of ASU 2017-12\)](#)
- ▶ To the Point publication, [FASB staff clarifies accounting for cash flow hedges disrupted by the COVID-19 pandemic](#)

### Intercompany transactions of a long-term investment nature

- ▶ Financial reporting developments, [Foreign currency matters](#)

### Revenue recognition

- ▶ Financial reporting developments, [Revenue from contracts with customers \(ASC 606\)](#)

### Compensation

- ▶ Financial reporting developments, [Share-based payment \(after the adoption of ASU 2018-07, Improvements to Nonemployee Share-Based Payment Accounting\)](#)
- ▶ Financial reporting developments, [Share-based payment \(before the adoption of ASU 2018-07, Improvements to Nonemployee Share-Based Payment Accounting\)](#)

### Income taxes

- ▶ Financial reporting developments, [Income taxes](#)
- ▶ Technical Line, [Accounting for the income tax effects of the CARES Act and the COVID-19 pandemic](#)

### Government assistance

- ▶ Financial reporting developments, [Income taxes](#)
- ▶ Technical Line, [How to account for proceeds from Paycheck Protection Program loans](#)

### Bankruptcy and liquidation

- ▶ Financial reporting developments, [Bankruptcies, liquidations and quasi-reorganizations](#)

### Consolidation

- ▶ Financial reporting developments, [Consolidation](#)

### SEC reporting and interim disclosures

- ▶ To the Point, [SEC extends relief and issues staff guidance on COVID-19 disclosures](#)
- ▶ Technical Line, [How to appropriately use non-GAAP measures to discuss the effects of COVID-19](#)