New Developments Summary

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COVID-19
Accounting and financial reporting considerations

The impact of COVID-19 is rapidly evolving, introducing volatility into the global economy, including disruptions in supply chains, the curtailing of consumer spending, unavailable employees or layoffs, and increasing volatility in the capital markets. COVID-19 may have a far-reaching impact on many entities, both directly and indirectly, as well as on accounting, disclosures, and internal controls for many entities. This publication has been updated to reflect the accounting implications of the CARES Act, as well as other recent developments, including the Consolidated Appropriations Act, 2021, which was signed into law on December 27, 2020.

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A. Accounting considerations

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

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

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

- Identifying information relevant to the estimate that is reasonably known or knowable as of the measurement date, which may include identifying related information after the measurement date but before the financial statements are either issued or made available to be issued.
- Interpreting identified relevant information to produce a reasonable and supportable forecast of future conditions.
- Utilizing a reasonable and supportable forecast of future conditions in the approach used to arrive at a quantitative estimate.
- Producing transparent and robust disclosures describing the key inputs and assumptions used in the entity’s estimation approach.

Subsequent events

Entities may become aware of COVID-19-related events after the balance-sheet date, but before the financial statements are either issued or available to be issued. Such events may include disruptions to the entity’s supply chains (or the supply chains of their customers), bankruptcy of customers, or government actions that could impact either the entity’s or customers’ activities. The guidance on subsequent events in ASC 855-10-25-1 requires an entity to evaluate whether those events provide evidence about conditions that existed at the balance-sheet date and to consider all information that becomes available before the financial statements are either issued or available to be issued. To the extent that identified COVID-19-related events provide evidence about conditions that existed as of the balance-sheet date, an entity needs to adjust its financial statements to reflect the impact of such events. On the other hand, to the extent that COVID-19-related events do not provide evidence about conditions that existed at the balance-sheet date, entities may consider whether it is necessary to disclose the nature of the event and an estimate of its impact on the financial statements (or a statement indicating that such estimate cannot be made) to prevent the financial statements from being misleading.

Although the first known case of COVID-19 was reported to the World Health Organization (WHO) on December 31, 2019, the likelihood of it becoming widespread and its potential impact on the global economy was largely unknown. Therefore, we generally believe that COVID-19 constitutes a nonrecognized subsequent event with regard to financial statements with a balance-sheet date on or before December 31, 2019.
Grant Thornton insights: SEC focuses on subsequent events and COVID-19

Entities will need to carefully consider whether to provide disclosures regarding the impact of COVID-19 on their business. Given the widespread impact of COVID-19 on both the global and U.S. economy, many entities will need to provide disclosures regarding COVID-19’s impact.

In fact, in two recent public statements, the SEC emphasized the importance of transparent and informative disclosures about the impact of COVID-19 on an entity’s operations and financial results.

On January 30, 2020, SEC Chairman Jay Clayton commented that while the effect of COVID-19 might be “difficult to assess or predict with meaningful precision,” this difficulty should not prevent entities from providing disclosures about the impact of COVID-19. "[H]ow issuers plan for that uncertainty and how they choose to respond to events as they unfold can nevertheless be material to an investment decision," he noted.

Additionally, on February 19, 2020, Chairman Clayton, SEC Division of Corporation Finance Director Bill Hinnman, SEC Chief Accountant Sager Teotia, and PCAOB Chairman William D. Duhnke III issued a joint public statement that emphasized "(1) the need to consider potential disclosure of subsequent events in the notes to the financial statements…and (2) [the SEC’s] general policy to grant appropriate relief from filing deadlines in situations where, in light of circumstances beyond the control of the issuer, filings cannot be completed on time with appropriate review and attention.” The SEC has provided conditional relief and assistance to entities affected by COVID-19. See Section B, “Disclosures,” for further discussion.

The SEC has summarized its response to COVID-19 here.

Goodwill and other indefinite-lived intangibles impairment

The guidance in ASC 350-20-35-30, Intangibles – Goodwill and Other, requires entities to test goodwill for impairment if “an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount” (called the “triggering event”). As a result, an entity should consider the direct and indirect impact of COVID-19 to determine whether a triggering event has occurred by evaluating all relevant facts and circumstances, including, but not limited to, all of the factors in ASC 350-20-35-3C.

ASC 350-20-35-3C

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

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

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

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

d. Overall financial performance such as negative or declining cash flows or a decline in actual or planned revenue or earnings compared with actual and projected results of relevant prior periods

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

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

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

If an entity concludes that a triggering event has occurred, it must test goodwill for impairment as of the date of the triggering event by comparing the fair value of the reporting unit to its carrying amount. Given the broad impact of COVID-19 on the global economy, it is likely that many entities will have a triggering event in the current environment. Goodwill is evaluated for impairment at the reporting unit level. If the carrying amount of a reporting unit exceeds its fair value as of the date of the triggering event, an impairment loss is recognized in an amount equal to that excess, limited to the total amount of goodwill allocated to that reporting unit.

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

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

Additionally, in volatile markets, it may be reasonable to look at market capitalization over a reasonable period of time leading up to the impairment testing date. What constitutes a “reasonable” period of time is a matter of judgment, and an entity should consider relevant recent events and trends in its share price.
when determining a reasonable period. For instance, in the current environment, it may be challenging to support the use of share prices prior to March 11, 2020, the date when the WHO declared COVID-19 a pandemic. Entities will need to support the range of dates used to determine market capitalization.

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

**Asset impairment**

The impact of COVID-19 on entities may manifest in a variety of ways, including reduced revenue, supply chain disruptions, temporary business closures, increased exposure to customers’ credit risk, or increased costs. These could be indicators of asset impairment, even over a relatively short duration, which entities need to consider.

**Long-lived assets**

The guidance on property, plant, and equipment in ASC 360-10-35-31 requires entities to evaluate long-lived assets “for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.” Entities may need to consider whether the direct and indirect impact of COVID-19 constitutes an event that would require testing long-lived assets for recoverability, such as (a) a significant decrease in the market price of the long-lived assets, (b) a significant adverse change in the extent or manner in which long-lived assets are being used or their physical condition, or (c) a significant adverse change in the business climate that could affect the value of the long-lived assets.

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

**Inventory**

The impact of COVID-19 on consumer and business spending might also affect the value of an entity’s inventory, which may require the entity to consider remeasurement or impairment. The guidance in ASC 330, *Inventory*, specifies two approaches for remeasuring inventory, depending on the cost method applied. In the first approach, inventory is remeasured using the lower of cost or net realizable value. This is used for all cost methods other than last-in, first-out (LIFO) or the retail method, and is widely applicable because many entities use the first-in, first-out (FIFO) or average cost methods. The second approach is the lower of cost or market that applies only when using LIFO or the retail method.

ASC 330 identifies a variety of circumstances that may require remeasurement, including inventory obsolescence and physical deterioration. Disruption of the supply chain or decreased demand associated with COVID-19 may have implications for or indicate inventory obsolescence and deterioration.

ASC 270, *Interim Reporting*, specifies that any loss resulting from remeasuring inventory in an interim period should be recognized in the interim period in which the decline occurs. Recoveries that occur in later interim periods within the same fiscal year are recognized as gains in the interim period in which they occur, not to exceed previously recognized losses. In addition, if a decline in an interim period can be reasonably expected to be restored within the same fiscal year, the temporary decline does not need to be recognized at the interim date. However, entities may not recognize recoveries related to impairments recognized in previous fiscal years.
Production capacity issues may result from temporary plant closings or supply chain disruptions. If inventory production levels drop below normal capacity, fixed overhead costs allocations to individual units of production generally should not increase in order to capitalize most or all of the costs in inventory. Instead, the unallocated overhead costs resulting from this “excess capacity” should be expensed in the period incurred. Judgment is required to determine both the range of normal capacity based on business and industry factors, and also when actual production levels fall below a reasonable range.

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

**Fair value measurement and impairment of financial assets**

**Fair value**

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

As a result of COVID-19, some markets have seen a decline in the volume or level of activity for certain assets and liabilities, which might make it difficult for entities to assess whether transactions in those markets are orderly. However, it is not appropriate to conclude that all transactions in a given market are not orderly. The determination of whether a transaction is orderly is made at the individual transaction level, considering the factors in ASC 820-10-35-54I. A transaction is not orderly if one or more of the market participants are compelled (not merely motivated) to transact. If an entity does not have sufficient information to conclude whether an observable transaction is orderly, it must take into account the transaction price. However, the entity may place less weight on such transactions in comparison to transactions that it knows to be orderly.

In addition to assessing whether observable transactions are orderly, entities need to consider other direct and indirect impacts of COVID-19 on the fair value of its investments, including changing credit spreads, implied volatility, and market liquidity.

**Impairment on investments in debt and equity securities**

Financial assets that are not carried at fair value, with changes in fair value recognized in earnings, are generally subject to one of several impairment models. Entities need to carefully identify the appropriate impairment model and consider if COVID-19 affects whether an impairment should be recognized and, if so, the extent of the impairment.
**Debt securities**

Debt securities may either be classified as trading, held-to-maturity (HTM) or available-for-sale (AFS). Trading securities are measured at fair value, with changes in fair value recognized in earnings.

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

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

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

**Equity securities without a readily determinable fair value**

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

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

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

Given the significant economic impact of COVID-19, it is likely that many equity securities for which the measurement alternative has been elected will have qualitative indicators of impairment.
If a qualitative assessment indicates that an equity investment is impaired, the entity should measure the equity investment’s fair value and record the difference between that fair value and the carrying value of the equity investment as an impairment loss in earnings.

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

**Equity method investments**

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

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

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

Entities with equity method investments must have a process to identify whether such evidence exists, considering the impact of COVID-19 on these factors. An entity that concludes the impairment of its equity method investment is other than temporary should write the investment down to its fair value. The unit of account for evaluating impairment on an equity method investment is the investment as a whole. An equity method investor does not separately test the investee’s underlying assets for impairment. However, the investor does recognize its proportionate share of any impairment recognized by the investee through the investor’s recognition of equity method earnings, including adjustments for basis differences.

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

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

**The current expected credit loss model**

ASU 2016-13 introduced a new topic to the FASB Codification, ASC 326, *Credit Losses*, and the CECL model to U.S. GAAP. The CECL model in ASC 326 requires entities to recognize an allowance for credit losses on financial assets measured at amortized cost as the difference between the amortized cost basis
of the financial asset and the amount the entity expects to collect. The CECL model can be thought of as having five components:

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

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

**Adopting CECL**

The new credit losses guidance in ASC 326 is effective as of January 1, 2020 for entities that are SEC filers, but are not designated as smaller reporting companies (SRCs), with calendar-year reporting dates.

ASC 326-10-65-1(c) requires an entity adopting ASC 326 to apply the guidance by means of a cumulative-effect adjustment to the opening retained earnings as of the beginning of the first reporting period of adoption. Accordingly, an entity will adjust opening retained earnings by estimating expected credit losses on its portfolio of financial assets measured at amortized cost as of the beginning of the fiscal year of adoption.

**Subsequent events and CECL**

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

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

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

With regard to information related to forecast assumptions used in estimating expected credit losses, the SEC staff clarified that information received before an entity has completed an appropriate estimation process could be included in the entity’s estimate of expected credit losses. That is, an entity may include information relating to forecasting assumptions used in estimating expected credit losses that is known or knowable as of the measurement date.
For instance, if after the balance-sheet date, but before the entity’s financial statements are issued or available to be issued, the U.S. government announces unemployment rates for a period that includes the measurement date, an entity may include such information in its estimation process regarding expected credit losses. While the unemployment rates may not have been available to the entity at the measurement date, the rates are known or knowable since the underlying economic condition (the rate of unemployment) existed and the U.S. government had access to the information.

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

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

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

**Considering the impact of COVID-19 on CECL**

Many entities adopting ASC 326 as of January 1, 2020 will be finalizing their transition adjustments during the first quarter of 2020. These entities may be considering whether the impact of COVID-19 should be incorporated in their opening balance-sheet retained earnings adjustment, or as a change in their estimate of expected credit losses during the first quarter of 2020.

Although the first known case of COVID-19 was reported to the WHO on December 31, 2019, the likelihood of a pandemic and its potential impact on the global economy were largely unknown. Therefore, we believe that the economic impact of COVID-19 should not be considered in an entity’s estimate of expected credit losses as of January 1, 2020.

With regard to CECL estimates after the initial adoption of ASC 326, entities estimating expected credit losses as of measurement dates subsequent to January 1, 2020 should consider information related to COVID-19 that was known or knowable as of that date. Such information may be included in the entity’s forecasting assumptions used in estimating expected credit losses.

In light of the information on COVID-19 that is known or knowable as of a subsequent measurement date, entities will need to evaluate the length of their reasonable and supportable forecast period. An entity may determine that the period over which it can reasonably and supportably forecast future conditions might be shorter due to the economic instability resulting from COVID-19.

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

Many commercial entities whose primary exposure to financial assets is short-term trade accounts receivables or contract assets may not have anticipated a significant change in their estimate of uncollectible receivables under the new CECL model. However, commercial entities must have a process for evaluating whether their reasonable and supportable forecast of future conditions indicates that their historical credit loss experience must be adjusted, such as for the impact of COVID-19.

Leases

Various aspects of accounting for leases might be impacted by COVID-19, including evaluating lessors’ lease-related financial assets for impairment and recognizing the effects of lease concessions whether pursuant to the enforceable terms of a lease or current negotiations between a lessee and lessor.

Lease-related financial assets

Lessors in sales-type and direct financing lease arrangements should follow the guidance on the impairment of financial assets in ASC 310 or ASC 326, as applicable, when assessing whether COVID-19 has impacted the credit losses on lease receivables.

Lessors in operating lease arrangements accounted for under ASC 842, however, need to consider whether it is no longer probable that they will collect the lease payments and any residual value guarantee from a lessee due to COVID-19’s impact. Under the guidance in ASC 842-30-25-13, if it is no longer probable that the lessor will collect the lease payments and any residual value guarantee from a lessee, the lessor should recognize a current-period adjustment to lease income equal to the difference between (a) the income that would have been recognized if collection were probable, including variable lease payments, and (b) the lease payments, including variable lease payments, that have been collected to date. As long as collectibility is not probable, a lessor’s operating lease income is limited to lease payments, including variable lease payments, collected from the lessee.

Rent concessions

With the economic uncertainty surrounding COVID-19, many lessees are asking for rent concessions, which are being granted by many lessors. A concession may take the form of free or reduced rent for a period, the deferral of rent, or some other type of relief.

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

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

The FASB staff recently issued a Staff Q&A addressing the accounting for lease concessions related to the effects of COVID-19 under ASC 842 and ASC 840, which simplifies the accounting for concessions made and received as a result of COVID-19.
FASB Staff Q&A

In its Q&A, the FASB staff notes that the guidance on accounting for lease modifications was written with routine lease changes in mind, not for the rapidly executed and widespread concessions granted in response to COVID-19. The staff believes that under both ASC 840 and ASC 842, an entity may treat qualifying lease concessions as if they were based on enforceable rights and obligations, and may elect to apply or not to apply modification accounting to those qualifying concessions. This election allows an entity to forego making a detailed review of each individual lease to determine if the lessee has an enforceable right to each concession.

According to the FASB staff Q&A, qualifying concessions must meet both of the following criteria:

- The concession is related to COVID-19.
- There is not a substantial increase in the lessee’s obligations or the lessor’s rights under the contract. For example, total payments required by the modified contract are substantially the same as or less than total payments required by the original contract.

Based on our discussion with the SEC staff, we believe that the SEC staff concurs with this view.

The Q&A states that an entity should apply its election consistently to contracts with similar characteristics and should disclose material concessions and the accounting for those concessions.

Concessions that are not modifications

A lease concession not accounted for as a modification is accounted for according to the terms of the concession.

A common form of lease concession discussed by the staff in the Q&A is a deferral of rent, which changes the timing, but not the amounts, of the rental payments. The staff noted that there could be multiple appropriate methods of accounting for a deferral under both ASC 842 and ASC 840, and described two of those methods in its Q&A:

1. Continue to account for the lease as if no deferral has been provided. A lessee should record a payable and a lessor should record a receivable for rental payments deferred.
2. Account for the deferred payments as variable lease payments.

Lessee rent deferral example

Assume that Lessor defers one period of Lessee’s rent, which will be paid in equal installments over the remaining life of the lease. Lessee has adopted ASC 842 and has classified the lease as an operating lease.

Under the method listed in the first bullet, at the end of the period for which rent is deferred, Lessee records its normal leasing journal entry, including straight-line rent expense, and the changes in the lease liability and the right-of-use (ROU) asset. But, instead of crediting cash, Lessee accrues a payable, which is relieved when the deferred rent is paid. Under this method, there is no impact to rent expense, the lease liability, or the ROU asset.
Under the method outlined in the second bullet above, Lessee records its normal entry to reduce both the lease liability and the ROU asset, and recognizes straight-line rent expense. But, instead of crediting cash, Lessee records a reduction to rent expense in the period of the deferral. When Lessee later incurs the deferred rent, it recognizes a variable rent expense.

**Lessor rent deferral example**

Assume that Lessor defers one period of rent, which will be paid in equal installments over the remaining life of the lease. Lessor has adopted ASC 842 and has classified the lease as operating.

Under the first method, at the end of the period for which rent is deferred, Lessor records its normal straight-line rental income. The receivable recorded as part of recognizing the normal straight-line rental income is relieved over time as Lessee pays the deferred rent. The lease remains subject to the collectibility guidance in ASC 842 for operating leases. Under this method, there is no impact to rental income.

Under the method outlined in the second bullet above, Lessor recognizes its normal straight-line rental income and receivable, but also recognizes negative variable rental income in the deferral period by crediting the receivable. Lessor recognizes the deferred amount as variable rental income in the period it is earned according to the deferral schedule.

**Concessions that are modifications**

For lease modifications that change the amount of consideration stated in the contract, ASC 842 requires a lessee to reassess lease classification, to remeasure and reallocate the consideration in the contract to the lease and nonlease components (unless the lessee elects to combine the components), and to recognize the adjustment to the lease liability, with an offsetting adjustment to the right-of-use asset.

Similarly, ASC 842 requires a lessor to reassess lease classification and to remeasure and reallocate the consideration in the contract for a lease modification that is not accounted for as a separate contract. The accounting entries depend on how the lease is classified both before and after the modification. For an operating lease that is modified in such a way that it remains an operating lease, it is important to note that a lessor should consider any prepaid or accrued rent associated with the original lease as part of the lease payments under the modified lease.

Finally, the determination of an entity’s incremental borrowing rate (IBR) is an important aspect of lease accounting under ASC 842. Entities need to evaluate whether the economic impact of COVID-19 has impacted their IBR and, if so, the impact on their lease accounting. If a lease is modified in a manner that does not constitute a new separate lease, a lessee must remeasure its lease liability based on its IBR on the modification date, assuming that the IBR is used as its discount rate for measuring its lease liability under ASC 842.

Hedge accounting

Entities that have hedged forecasted transactions in a cash flow hedge under the guidance in ASC 815, Derivatives and Hedging, may need to consider whether the forecasted transactions are still probable of occurring in light of the impact of COVID-19.

If an entity determines that a hedged forecasted transaction is no longer probable of occurring, then the entity should discontinue cash flow hedge accounting for that forecasted transaction under the guidance in ASC 815. If an entity determines that it must discontinue cash flow hedge accounting, its subsequent accounting for any amounts associated with the hedge that are deferred in accumulated other comprehensive income will depend on the likelihood that the forecasted transaction will occur. If it is probable that the forecasted transaction will not occur by the end of the originally specified time period or within a two-month period of time thereafter, then the entity must immediately reclassify to earnings any amounts previously recognized in accumulated other comprehensive income. In rare cases in which extenuating circumstances outside the control or influence of the entity cause the forecasted transaction to remain probable of occurring but on a date beyond two months following the originally specified time period, amounts deferred in accumulated other comprehensive income should remain deferred in accumulated other comprehensive income. Amounts that remain in accumulated other comprehensive income (that is, they are not required to be immediately recognized in earnings) upon discontinuation of a cash flow hedge should be recognized in earnings when the forecasted transaction affects earnings.

During the April 8, 2020 FASB meeting, the FASB staff provided feedback on a technical inquiry received regarding discontinued cash flow hedges. Specifically, the FASB staff explained that the exception in ASC 815-30 related to rare cases caused by extenuating circumstances outside the control or influence of the entity may be applied to COVID-19-related delays in the timing of the forecasted transactions. Therefore, for discontinued hedges where the forecasted transaction is delayed due to COVID-19 but is still probable of occurring, even if the transaction is not expected to occur within the two-month period following the original expected timing, an entity may continue to defer amounts recorded in other comprehensive income until the forecasted transaction affects earnings.

Revenue recognition

Variable consideration

COVID-19 may impact estimates of variable consideration in contracts with customers. Under the revenue recognition guidance in ASC 606, entities with customer contracts that include variable consideration (for example, rebates, discounts or price concessions) are required to estimate the amount of consideration to which they will be entitled in exchange for transferring promised goods or services. Entities should include variable consideration in the contract transaction price only to the extent that it is probable a significant reversal of cumulative revenue recognized will not occur when any related uncertainties are resolved. Variable consideration that is not included in the transaction price at contract inception (known as “constrained” revenue) is subsequently included when either (a) it becomes probable that a significant reversal will not occur, or (b) the uncertainty related to the variable consideration is resolved.

Entities that enter into contracts with variable consideration must update their estimates of variable consideration over the life of the contract based on facts and circumstances that are known or knowable at each reporting date. As a result, an entity may need to consider the impact of COVID-19 on its estimate of variable consideration.
**Modifications**

Economic uncertainties that have resulted from COVID-19 may lead many vendors and customers to modify existing contracts. When there is a change in the scope, price, or both in a contract and the change is enforceable, a contract modification exists, and modification accounting under ASC 606 should be applied.

**Collectibility**

The economic volatility stemming from COVID-19 may impact an entity's ability to collect amounts resulting from contracts with customers. Entities may need to consider changes in collectibility with regard to existing account receivable balances, which are evaluated for credit losses in accordance with ASC 310 or ASC 326, as applicable. The impact on estimates of credit losses was discussed earlier under “Fair value measurement and impairment of financial assets.”

In addition to evaluating credit losses, entities will also need to reassess whether, due to changes in collectibility, a contract continues to exist for accounting purposes for the remaining goods or services to be provided under the contract. The probability of collection is one of the criteria in Step 1 for determining whether a contract exists for accounting purposes in ASC 606. Once a contract meets the Step 1 criteria, an entity is precluded from reassessing whether it continues to pass Step 1, unless there is an indication of significant changes in facts and circumstances. When those significant changes occur, an entity should reassess collectibility in the context of future consideration for the remaining goods or services under the contract. If it is no longer probable that the entity will collect substantially all of this future consideration, ASC 606 generally requires the entity to stop recognizing further revenue and provides guidance on how to continue to assess Step 1 until either the criteria in Step 1 are subsequently met or the contract is terminated.

For new contracts, entities should consider the effects of COVID-19 on collectibility. In the current business environment, probability of collection of substantially all of the consideration might be less straightforward. A contract would not exist under Step 1 if collectibility is not probable.

**Estimates in new contracts**

In addition to reassessing ASC 606 estimates related to existing contracts, entities should similarly consider the impact of COVID-19 on estimates involved with accounting for new contracts with customers being executed during this time of uncertainty and volatility. An entity’s historical judgments and estimates may be impacted, including collectibility, stand-alone selling prices, potential price concessions, contract assets, and product returns, among others.

**Costs to obtain and fulfill a contract**

Costs to obtain and costs to fulfill contracts are capitalized under the guidance in ASC 340-40, *Other Assets and Deferred Costs: Contracts with Customers*. Under that guidance, an entity should recognize an impairment loss in earnings if the consideration the entity either expects to receive in the future or has received but has not yet recognized as revenue, minus the costs directly related to providing goods or services that have not yet been expensed, is less than the carrying amount of the capitalized costs. Entities should consider whether changes in estimates of either the amount of consideration the entity expects to receive or the costs directly related to providing the goods or services as a result of COVID-19 indicate that the carrying amount of costs to obtain and fulfill contracts is impaired. However, prior to
assessing whether capitalized costs to obtain and fulfill contracts are impaired, an entity should first perform an impairment assessment on assets related to the contract that are outside the scope of ASC 340 (for example, inventory accounted for under ASC 330). Next, an entity should apply the impairment guidance to assets related to the contract that are recognized in accordance with ASC 340.

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

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

**Contract assets**

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

**Disclosures**

ASC 606 requires disclosures about changes in judgments and about other matters, such as the impairment of contract assets. Therefore, the impact of COVID-19 may trigger the need for incremental disclosures, including the methods, inputs, and assumptions used for estimating variable consideration and constrained amounts; the timing of satisfying performance obligations; and other aspects of revenue recognition.


**Government assistance**

Governments around the world are looking to provide assistance to entities as a result of the impact of COVID-19. There are various methods that governments are considering, including debt forgiveness.

The accounting and disclosure requirements for government assistance depend on whether the assistance is considered a loan, payment for a good or service, an income tax credit, a contribution, or a grant.

**Government assistance related to income taxes**

If government assistance is in the form of an income tax credit or other income tax relief, then the entity should account for the transaction in accordance with the guidance for income taxes in ASC 740. If the credit is not based on taxable income, it would typically fall outside the scope of ASC 740.

**Government assistance when the government may be a customer**

Many entities currently have contracts in place to provide goods or services to government entities, which either have been, or will be, modified under the current circumstances. An entity that receives a form of government assistance must determine whether the assistance represents a revenue contract (or contract modification) for the transfer of goods or services consistent with its ongoing revenue-generating activities and with commercial substance. If not, the assistance is another type of transaction.
**Government assistance as a government grant**

U.S. GAAP does not provide specific guidance on the accounting for government grants awarded to business entities. Business entities that receive government grants may consider accounting for these grants by analogizing to one of several recognition models, including the guidance on contingent gains in ASC 450-30 or on government grants and assistance in International Accounting Standard (IAS) 20.

Under IAS 20, government grants are recognized when there is reasonable assurance that the grant will be received, and all conditions related to the grant will be met. These grants should be recognized in income on a systematic and rational basis over the period when the entity incurs costs related to the grant, after considering any clawback conditions. The manner in which the grant is received, such as a reduction of a liability or a cash payment, does not impact the accounting. IAS 20 also states that a forgivable loan from a government should be treated as a government grant when there is reasonable assurance that the entity will meet the terms for forgiveness of the loan.

Under the IAS 20 model, there are two types of government grants: income-related and asset-related. The primary condition of an asset-related grant is that the entity qualifying for the grant should purchase, construct, or otherwise acquire long-term assets. An asset-related government grant might also feature subsidiary conditions that could restrict the type or location of the assets or the periods during which they are acquired or held. All other government grants are considered income-related.

For asset-related government grants, IAS 20 includes two acceptable methods of presenting the amount received under the grant in the financial statements. Under the first method, an entity initially recognizes the grant as a deferred income liability that is subsequently recognized in income pursuant to a systematic basis over the useful life of the related asset. Under the second method, the carrying amount of the asset is calculated, net of the proceeds received under the grant, and the grant is recognized in income over the life of a depreciable asset as a reduction to depreciation expense. However, under both methods, the receipt of the grant and purchase of the related asset are separately presented in the statement of cash.

Similarly, for income-related government grants, IAS 20 also includes two acceptable methods for presenting the amount received under the grant. Under the first method, the amount of the grant is presented separately in income. Under the second method, the amount of the grant is deducted from the related expense.

Under IAS 20, if a government grant becomes repayable, it should be accounted for as a change in estimate. Repayment of an asset-related grant should be recognized by increasing the carrying amount of the asset or reducing the deferred income balance by the amount repayable. Additionally, an entity should immediately recognize in income the cumulative additional depreciation that would have been recorded if the amount repaid had always been part of the cost basis of the asset. Repayment of an income-related grant should be applied first against any deferred credit recognized from the grant and then the remainder to income.

**Paycheck Protection Program**

The CARES Act (including subsequent amendments) earmarked over $600 million for potentially forgivable loans to support eligible small businesses impacted by COVID-19 through the Paycheck Protection Program (PPP), administered by the Small Business Administration (SBA). The loans, which have a two-year term and bear interest at 1 percent, are provided through SBA-approved lenders to an eligible entity that can certify the PPP loan is necessary to support its ongoing operations as a result of COVID-19.
Entities that may be eligible for PPP loans include

- A “small business” that meets the SBA’s size standards
- Any business or nonprofit organization that has fewer than 500 employees
- Any business in the accommodation and food service industry (any NAICS Code that begins with 72) with fewer than 500 employees per location
- Sole proprietors, independent contractors, and self-employed persons

To assert the necessity of a PPP loan, as noted in the SBA’s Paycheck Protection Program Loans – Frequent Asked Questions (FAQs), an entity should take into account its ability to access other sources of liquidity sufficient to support its ongoing operations in a manner that is not significantly detrimental to its business. The FAQs note that it is unlikely that a public company with substantial market value and access to capital markets, or a private company with adequate sources of liquidity, will be able to make the required certification in good faith. The FAQs also note that an entity (together with any affiliates) that receives a PPP loan of less than $2 million will be deemed to have made the required certification of need in good faith.

A portion of the borrower’s PPP loan will be forgiven, equal to eligible payroll costs, interest payments on mortgages, and rent payments and utility payments made during a certain period of time, provided that (1) the entity maintains specified employee and payroll levels during that period, and (2) at least 75 percent of the eligible expenditures are used for payroll. Amounts borrowed that are not forgiven must be repaid by the borrower (though repayment to the lender is guaranteed by the SBA).

As noted in FAQ 46, all PPP loans in excess of $2 million will be subject to review by the SBA for compliance with PPP requirements, including initial eligibility.

Grant Thornton insights: Borrower accounting for PPP loans

All entities, other than not-for-profit entities, that receive PPP loans may account for the loans either as debt or, in certain circumstances, as in-substance government grants. Both accounting approaches are discussed below.

Accounting for PPP loans as debt

Because PPP loans are legal form debt, it is appropriate for a borrower to account for these loans as debt under the guidance in ASC 470, Debt, by accruing interest over the term of the loan at its effective interest rate. Borrowers are not required to impute a market rate of interest to government-guaranteed obligations, such as PPP loans, under the guidance in ASC 835-30, Interest: Imputation of Interest.

Under ASC 470, the debt would be derecognized when the debt is extinguished in accordance with the guidance in ASC 405-20, Liabilities: Extinquishments of Liabilities. Under this guidance, debt is extinguished when either of the following conditions is met:

- The debtor pays the creditor.
- The debtor is legally released from being the primary obligor either judicially or by the creditor.
The SBA’s criteria for forgiveness may be subject to change, and borrowers should carefully monitor for new developments.

When the debt is extinguished, any amount that is “forgiven,” meaning the borrower is not required to repay the amount, is recognized in the income statement as a gain on debt extinguishment.

In the statement of cash flows, the amount borrowed under a PPP loan is shown as a cash inflow from financing activities, while principal repayments are shown as cash outflows from financing activities and interest payments are shown as cash outflows from operating activities. Any amounts of principal forgiven are shown as noncash financing activities, and interest forgiven is disclosed as a noncash operating activity.

**Accounting for PPP loans as government grants**

Based on discussions with the SEC staff, we believe that a borrower may elect to account for the PPP loan as a government grant in substance by applying IAS 20 by analogy if the entity believes that it is probable that it (a) meets the eligibility criteria for a PPP loan, and (b) will meet the loan forgiveness criteria for all or substantially all of the PPP loan. If the entity cannot support that it is probable that it will comply with both the eligibility and forgiveness criteria, the PPP loan should be accounted for as debt. The assessment of whether it is probable that a borrower will meet the eligibility and forgiveness criteria is an ongoing one, and the borrower will need to monitor developments regarding the SBA’s evaluation of eligibility and criteria for debt forgiveness.

As noted above, U.S. GAAP does not have specific guidance on accounting for government grants to business entities that are not in the form of a tax credit. If an entity has previously established an accounting policy to account for government grants (for instance, a healthcare entity that applies ASC 450-30 to account for payments received for electronic health record technology under the American Recovery and Reinvestment Act of 2009), it should first consider whether that accounting policy could be applied to PPP loans.

However, many businesses do not have an established policy for accounting for government grants or may conclude that PPP loans are not similar to government grants received in the past, so they will need to establish a new accounting policy.

**IAS 20**

Under IAS 20, a borrower would account for a PPP loan as an income-related grant and initially recognize the loan as a deferred income liability. The borrower would then recognize the loan in income on a systematic and rational basis in those periods over which the entity recognizes the expenses that the grant is intended to offset. Under IAS 20, the income-statement impact of any loan forgiveness may either be presented separately or offset against the related expenses. If a borrower initially concludes that it is probable it will meet the criteria for loan forgiveness and therefore accounts for the PPP loan as an in-substance government grant, but subsequently discovers that a portion or all of the PPP loan is repayable, it should account for the change in expectation as a change in estimate.

With regard to the statement of cash flows, a borrower may make an accounting policy election to account for the proceeds received, paid, and forgiven on a PPP loan within the same section of the statement of cash flows where the expenses related to the loan are presented. However, a borrower may also make an accounting policy election to present the PPP loan as a traditional borrowing.
Disclosure

Regardless of the accounting approach followed by a borrower, if the PPP loan is material to the financial statements, the borrower should disclose in the footnotes how the PPP loan was accounted for and where the related amounts are presented in the financial statements, including on the statement of cash flows. Additionally, the borrower should consider the specific disclosure requirements of the relevant accounting guidance applied to the PPP loan (that is, ASC 470, IAS 20, or ASC 450-30).

Public companies should consider other disclosure requirements outlined in Regulation S-X, including risk factor disclosures for meeting the eligibility and forgiveness requirements, liquidity disclosures regarding the potential for repayments of amounts borrowed, and whether conclusions regarding the entity’s ability to remain a going concern are premised upon receiving debt forgiveness for the PPP loans.

Tax implications of PPP loan proceeds and forgiveness

Section 1106(i) of the CARES Act allows entities to exclude income associated with the forgiveness of PPP loans from gross income for tax purposes, resulting in a permanent book-to-tax difference in the year when the loan forgiveness is recognized for financial statement purposes. This anticipated tax benefit should be accounted for as a discrete event in the quarter recognized.

For entities that account for PPP loans as loans under ASC 470, interest is accrued on the loan for financial statement purposes. However, there may be diversity in practice in how entities treat contractual interest on PPP loans for income tax purposes. Any book-to-tax differences should be accounted for as a deferred tax item in the financial statements and should then be reversed when the forgiveness of the accrued interest is recorded in the financial statements.

Compensation

Benefits

Short-term employment benefits

In light of COVID-19, various short-term benefits may be provided to employees and furloughed employees. These benefits may include salary continuation, child care services, and additional sick leave. Different benefits may be accounted for differently under U.S. GAAP, depending on the nature of the benefit provided. Benefits such as salary continuation should be accrued when it is probable that the benefits will be paid and the costs are estimable. Benefits such as sick leave should be accounted for as a compensated absence in accordance with ASC 710, Compensation, and accrued if it is determined that the leave can be carried forward into periods after they are earned.

Postemployment benefits

Unfortunately, entities may reduce workforces as a result of the economic volatility due to COVID-19 and incur increased costs of postemployment and postretirement benefits. Postemployment benefits, such as termination or severance benefits, and the continuation of employment benefits such as medical insurance should be accounted for under ASC 712, Compensation – Nonretirement Postemployment Benefits. These benefits are recorded based on the type of benefit: contractual termination benefits, special termination benefits, or other postemployment benefits. Contractual termination benefits are
recognized as a liability and expensed when it is probable that the employee will be entitled to benefits and the amount can be reasonably estimated, including the amount of any lump-sum payments and the present value of any expected future payments. Special termination benefits are recognized when the offer is accepted and the amount can be reasonably estimated.

**Postretirement benefits**

Postretirement benefits, such as defined contribution or benefit plans, are accounted for in accordance with ASC 715, *Compensation – Retirement Benefits*. Entities with postretirement plan assets and obligations typically remeasure them at the end of a fiscal year based on actuarial assumptions at the measurement date, including market prices and discount rates. Entities are not required to remeasure their plan obligations and assets solely due to changes in the fair value of plan assets related only to current market conditions, which means that remeasurements are not required solely because of the current market volatility. On the other hand, entities are generally required to remeasure their plan assets and obligations at interim dates if certain significant events occur, such as a plan amendment, settlement, or curtailment. When measuring the postretirement obligation for an amendment, current economic conditions, such as a decline in the equity markets, interest rates, and other changes to actuarial assumptions as of the measurement date, should be included in the calculations. Additionally, discount rates should be based on high quality bonds whose ratings may be affected during times of economic uncertainty.

**Stock compensation arrangements**

The impact of COVID-19 may also have an effect on the accounting for share-based payment arrangements. The nature of the effect depends primarily on the award’s classification as equity or liability, whether performance conditions are present, and whether the awards are modified.

**Evaluation of awards that have not been modified**

Unmodified equity-classified awards with service and/or market conditions should see the least impact from COVID-19 because the grant-date fair value is the basis for expense recognition, and that value is generally not revisited unless there is a modification. Otherwise, equity-classified awards with only service conditions generally are expensed over the requisite service period and will continue to be expensed as long as the awards are not forfeited. Equity-classified awards with market conditions, on the other hand, will continue to be expensed over the period determined at the grant date, regardless of whether the underlying market condition (for example, the grantor’s stock price) has declined, even if it is unlikely that the market condition will ever be satisfied. Any amounts expensed under such awards are not reversed, even if the condition ultimately is not achieved.

Many entities grant awards with performance conditions that must be achieved in order for the awards to vest, but in the current environment, many awards that had been probable of vesting now may be improbable of vesting. Entities must reassess the probability of achieving the performance condition each period. For example, assume that an award vests if sales or EBITDA exceeds a stated target over a period or periods of time. As long as the entity concludes that meeting the target is probable, the grant-date fair value is recognized as a compensation cost over the requisite service period. If the entity determines in a period that meeting the target has become improbable, the prior compensation cost is reversed through a cumulative catch-up adjustment. If the condition is later probable of achievement, a cumulative catch-up adjustment would be recorded to recognize cost through that date.
Liability-classified awards are required to be remeasured each reporting period, even if vested, until they are settled or no longer liability-classified. To the extent that the fair value of liability-classified awards has decreased in the current environment, the periodic remeasurement will adjust the liability and cumulative compensation cost downward to reflect the current value.

Additionally, for both equity- and liability-classified awards, entities that include forfeitures in their estimate of compensation expense should reevaluate the forfeiture rate at each reporting period. In light of COVID-19 and the resultant economic uncertainty, the rate might change more than in a typical period.

**Evaluation of awards that have been modified**

Entities may modify the terms of their share-based payment awards in response to the impact of COVID-19. For instance, entities may reduce option exercise prices, extend the period over which options may be exercised, or change performance conditions so that they are more reasonably achievable. Modifications also may occur as part of severance packages that accelerate the vesting of unvested awards as employees leave the entity. There are many different types of modifications and the accounting can be complex, with a significant impact.

Awards with service-only conditions generally are considered probable of vesting over the stated time period, both before and after modification. This contrasts with awards with performance conditions for which the probability of achievement could change upon modification, and entities must consider the probability both before and after the modification. When an entity expects an award to vest under the original terms of the award based on the conditions present at the date of the modification (for example, the passage of time for service or the achievement of performance conditions), the total compensation cost recognized under the award is the sum of the fair value of the original award plus any incremental value attributable to the modified award. Generally, the total compensation cost may not be less than the original grant-date fair value, even if the fair value of the modified award is lower than the original award at the modification date. There is a difference in accounting for an award with a performance condition that, at the modification date, the entity does not expect to vest under the original terms (in other words, vesting is improbable). In this case, the total compensation cost of the award equals the modified award’s fair value at the modification date, without regard to the original grant-date fair value.

Market conditions, on the other hand, are not considered to be vesting conditions, and therefore the probability of achieving a market condition does not impact the total compensation cost to be recognized in a modification. As a result, the original grant-date fair value may not be disregarded and the modification accounting focuses on whether there is incremental fair value. Presuming the requisite service is provided, this means that the ultimate cost recognized for a modified market condition award will be no less than the original grant-date fair value and will be a greater amount if there is an incremental cost arising from the modification.

Some entities may consider accelerating the vesting of options that are deep-out-of-the-money and may no longer effectively promote employee motivation in the current circumstances. Normally, if awards are modified to accelerate vesting, all unrecognized compensation cost is recognized immediately on the modification date. But there is specific guidance for modifying deep-out-of-the-money options that does not apply to unvested share awards. If the accelerated options are deep-out-of-the-money, they may still be unexercisable because the exercise price is much higher than the current-share market price. Accordingly, the modified options may be thought to have an in-substance market condition, which is that the entity’s share price must increase to the options’ exercise price before the employee can benefit from exercise. This results in a derived service period, and the cost is recognized over that period.
Evaluation of awards that have been cancelled or replaced

The cancellation of awards with no offer to replace them might arise more often in a period of economic uncertainty because awards may lose both their value and the ability to act as an incentive. Entities that have little or no experience with cancellations may be surprised by the accounting impact, even if the fair value upon cancellation is less than the grant-date fair value. Therefore, entities should carefully consider the implications of cancelling an award. If an award is cancelled for no consideration and is not accompanied by a concurrent grant or an offer to grant a replacement award, it is accounted for as a repurchase for no consideration and the entire cost of the award is recognized when it is cancelled under ASC 718. An exception is an award with a performance condition that is not probable of achievement as of the cancellation date. In this case, the fair value of the cancelled award generally would not be recognized.

In contrast to recognition of the entire cost upon a cancellation, a cancellation accompanied by a concurrent grant (or replacement) is accounted for as a modification and the impact is typically based on whether the replacement award will provide incremental fair value over the cancelled award.

Refer to our publication, *Share-based payments: Navigating the guidance in ASC 718*, for further discussion.

Creditors accounting for loan restructurings

On March 22, 2020, various federal and state financial institution regulatory agencies (the agencies) issued an Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus. The interagency statement provides the agencies’ views on whether loans restructured by creditors in response to COVID-19 are troubled debt restructurings under ASC 310-40, Receivables: Troubled Debt Restructurings by Creditors. The FASB has concurred with the accounting interpretation provided in the interagency statement.

Following the enactment of the CARES Act on March 27, 2020, the agencies revised their interagency statement to address the interaction between Section 4013 of the CARES Act and the statement.

Interaction between interagency statement and CARES Act

Section 4013 of the CARES Act provides financial institutions with an option to suspend the application of ASC 310-40 to eligible loan restructurings. A loan restructuring is eligible under Section 4013 if the restructuring is related to COVID-19, the loan was not more than 30 days past due as of December 31, 2019, and the restructuring is executed between March 1, 2020 and the earlier of 60 days after the termination of the national emergency or December 31, 2020.

If a loan restructuring is not eligible under Section 4013, or if the financial institution does not elect to avail itself of the optional relief in Section 4013, the financial institution should evaluate the loan restructuring under ASC 310-40. However, like other entities, a financial institution evaluating a restructuring under ASC 310-40 may also consider the guidance in the interagency statement.

The following chart illustrates the interaction between Section 4013 and the interagency statement.
Identifying TDRs

Under ASC 310-40, a creditor who restructures a loan must evaluate whether the restructuring constitutes a troubled debt restructuring (TDR).

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

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

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

Evaluating financial difficulty

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

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

**Evaluating whether a concession is granted**

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

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

**Interagency guidance**

According to the interagency statement, short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief are not considered to be TDRs under ASC 310-40. Creditors may presume that a restructuring is not a TDR if the following criteria are met:

- The restructuring is in response to the national emergency.
- The borrower was current on payments (less than 30 days past due on contractual payments) at the time the modification program is implemented.
- The restructuring is short-term (six months or less).

Qualifying restructurings may include payment deferrals, fee waivers, extension of repayment terms, or delays in payment that are insignificant.

Restructurings that do not meet the criteria above are not automatically considered TDRs, but should be further evaluated under the guidance in ASC 310-40.

Restructurings or deferral programs mandated by the federal or a state government related to COVID-19 are not within the scope of the TDR guidance in ASC 310-40.

**Restructurings that are not TDRs**

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

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

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

Under the guidance in ASC 310-20-35-11, a restructuring is more than “minor” if the present value of the cash flows under the restructured terms is at least 10 percent different from the present value of the remaining cash flows under the terms of the original instrument. If the present value of the cash flows is not more than 10 percent different from the present value of the remaining cash flows under the terms of the original instrument, then a creditor must consider other relevant considerations surrounding the restructuring to determine if the restructuring is more than minor.
If a restructured loan is considered a new loan, any unamortized net fees or costs, and any prepayment penalties from the original loan, should be recognized in interest income when the new loan is granted.

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

**Interest income recognition**

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

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

**Borrower accounting for loan restructurings**

Entities significantly impacted by COVID-19 may request accommodation from their lenders, including temporary payment deferrals, modifications to or waivers of violations of debt covenants, or changes to other terms of their debt agreements. Such accommodations are debt modifications and should be carefully evaluated to determine the appropriate accounting treatment.

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

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

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

- Determine the contractual cash flows of the restructured debt.
• If the total cash flows on the restructured debt are less than the carrying amount of the debt, reduce the carrying amount of the debt to the total contractual cash flows and recognize the reduction in the carrying amount of the debt as a gain on debt extinguishment.

• If the total cash flows on the restructured debt are greater than the carrying amount of the debt, determine a new effective interest rate that equates the total contractual cash flows to the carrying amount of the debt.

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

Exit or disposal activities

Entities may determine in periods of economic uncertainty to sell or dispose of various assets or a subsidiary or to restructure the entity. The guidance in ASC 420, Exit or Disposal Costs, should be followed in these circumstances. Events that may constitute an exit or disposal activity under ASC 420 include

• One-time termination benefits to current employees that are involuntarily terminated under the terms of a benefit arrangement that is not an ongoing benefit arrangement (or plan) or an individual deferred compensation plan

• If the entity has not yet adopted ASC 842, costs to terminate a lease contract that is not a capital lease

• Costs to consolidate facilities or relocate employees

• Costs associated with a disposal activity

• Costs associated with an exit activity, including exit activities related to a newly acquired business combination or an acquisition by a not-for-profit entity

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

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

Insurance recoveries

Entities may be entitled to reimbursement for losses under various types of insurance policies as a result of COVID-19. Generally, probable insurance recoveries are recognized in advance of their receipt only to
the extent of the losses previously recognized, while business interruption insurance on lost revenue is generally not recognized until received.

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

**Income taxes**

Entities will need to consider the impact of the economic effects of COVID-19 in their accounting for income taxes. Areas of accounting for income taxes that may require analysis include

- Assertions regarding the indefinite reinvestment of foreign earnings
- Realizability of deferred tax assets
- Tax accounting method changes
- Determinations of the estimated annual effective tax rate in interim periods

Additionally, the federal and state governments may enact tax law changes in response to COVID-19. An entity recognizes the effects of an enacted change in tax laws or rates in the period that includes the enactment date—that is, the date a tax bill becomes law—in accordance with ASC 740-270-25-5.

See [NDS 2020-07](#) for a comprehensive discussion of the impact of COVID-19 on the accounting for income taxes.

**B. Disclosures**

Entities affected by COVID-19 need to consider the implications on disclosures in their financial statements. The degree of disclosure required in an affected entity’s financial reporting depends on the nature, duration, and extent of COVID-19’s impact on the entity. Entities need to continue monitoring developments related to COVID-19 and to evaluate the appropriateness of their disclosures in light of changes caused by COVID-19.

**Contingent losses**

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

Entities will need to consider whether events related to COVID-19 indicate that it is reasonably possible they have incurred a contingent loss and to make disclosures as appropriate. For instance, an entity that provides for self-insurance for medical claims by its employees may need to consider whether it is reasonably possible that, at the measurement date, its employees have had exposure to COVID-19 that will result in additional medical claims made on the entity.

**Going concern**

The guidance in ASC 205-40, *Presentation and Disclosure: Going Concern*, requires entities to evaluate their ability to continue as a going concern within one year after the financial statements are either issued or made available to be issued. An entity that concludes that there is substantial doubt about its ability to continue as a going concern, or that its plans alleviate that doubt, must provide disclosures to that effect.
An entity may need to evaluate whether its analysis sufficiently considers the impact of COVID-19 when determining whether substantial doubt exists about its ability to continue as a going concern for one year after the date of the financial statements, or whether its plans alleviate substantial doubt.

**Risks and uncertainties**

Under ASC 275, *Risks and Uncertainties*, entities are required to make qualitative disclosures about risks and uncertainties that could significantly impact the amounts reported in the financial statements in the near term (that is, within one year from the date of the financial statements). Entities may need to evaluate whether it is necessary to include specific disclosures related to risks and uncertainties introduced by COVID-19, including disclosures for significant accounting estimates and vulnerabilities due to concentrations in vendors or customers.

**MD&A and Risk Factors**

In addition to disclosures in their financial statements, entities may need to provide additional disclosures about the impact of COVID-19 in their SEC filings under Regulation S-X in both Management’s Discussion and Analysis (MD&A) and Risk Factors.

**MD&A**

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

**Risk Factors**

Entities also need to disclose significant risks that may impact their results and the securities they have issued. Entities should consider whether it is necessary to include specific risk factors related to COVID-19 and their possible impact on their business.

**C. Internal control over financial reporting**

Entities affected by COVID-19 need to consider its impact on their internal control over financial reporting (ICFR), including whether new controls are necessary or if existing controls have been modified as a result. Situations related to COVID-19 that may impact an entity’s control environment include, but are not limited to, the following:

- Absences of personnel that execute controls due to illness, office closings, or mandated work arrangements that prevent them from executing controls as designed
- Inadequate information necessary to complete certain controls due to geographical limitations
- Changes to existing controls that may create segregation of duties issues
- New controls that may not operate for a sufficient period of time to allow management or the audit team to conclude on their operating effectiveness

New controls or modified controls that are not suitably designed or operating effectively could result in deficiencies in internal controls that are not mitigated by other existing or new controls.

Additionally, COVID-19 may impact management’s ability to complete the financial statement closing process and any associated internal controls in order to prepare the financial statements in a timely fashion. Although many entities may extend their reporting deadlines, these extended timelines could
introduce an increased potential for error in the financial statements related to the identification of subsequent events. An entity’s controls over financial reporting also need to include controls over disclosures in the financial statements, including the adequacy of disclosing the effects of COVID-19 and the selection and application of GAAP for accounting for and disclosing matters arising from COVID-19.

For public entities, any changes in internal controls that have materially affected, or are reasonably likely to materially affect, an entity’s ICFR are required to be disclosed in Form 10-Q or Form 10-K of the entity’s quarterly or annual filings, respectively.

D. SEC relief

**Exchange Act filing deadlines**

The SEC has issued an order that provides conditional regulatory relief and assistance to SEC registrants affected by COVID-19. To address potential issues with meeting reporting obligations under the federal securities laws, SEC registrants are now provided with an additional 45 days to file certain disclosure reports that would otherwise be due from March 1 to July 1, 2020.

For registrants affected by COVID-19 that are subject to the reporting requirements of Sections 13(a) or 15(d) under the Securities Exchange Act of 1934 (Exchange Act), deadlines for materials filed or furnished under certain sections and rules of the Exchange Act are extended for the period from and including March 1 to July 1, 2020. All reports, schedules, or forms must be filed no later than 45 days after the original due date. Each report, schedule, or form must be filed on or before the specified date; must disclose reliance on the order; and must specify the reasons why, in good faith, the filing is delayed.

Registrants seeking to rely on the order are required to furnish Form 8-K or Form 6-K, as applicable, by the later of March 16, 2020 or the original reporting deadline. The form must (i) state that the registrant is relying on the order; (ii) include a brief description of the reasons why it could not file on a timely basis; (iii) indicate the estimated date of the anticipated filing; and (iv) include a risk factor explaining the effect that COVID-19 has had on its business, if material.

Further, if the reason for the delayed filing is due to the inability of any person, other than the registrant, to provide any required opinion, report, or certification, a statement signed by such person specifying the reasons for the delay must be attached as an exhibit to Form 8-K or Form 6-K, as applicable.

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**Grant Thornton insight: Impact on financial statement disclosures**

Registrants that can file periodic reports by the prescribed due dates, and do not need the relief provided by the Commission, may still be impacted by COVID-19. All companies may need to assess whether disclosure is required regarding material risks to their business, as well as plans to address such risks.

In connection with the relief discussed above, the Commission announced positions that its staff will take under both the Exchange Act and the Securities Act of 1933 for determining whether a reporting company has satisfied certain reporting requirements, including the following positions:

- For purposes of determining whether an entity is eligible to use Forms S-3 and S-8, to file as a well-known seasoned issuer, and to be exempt from registration pursuant to Rule 144(c), the entity relying
on the order will be considered current and timely in its Exchange Act reports if it was current and timely as of the first day of the relief period and it files any required report under the order within 45 days of the filing deadline for the report.

- Entities that receive an extension for filing quarterly or annual Exchange Act reports pursuant to the order remain eligible to rely on Exchange Act Rule 12b-25 when they are unable to file the required reports on or before the extended due date.

**Relief for funds and advisers affected by COVID-19**

The SEC recently issued two additional orders to provide regulatory relief and assistance to funds and investment advisers affected by COVID-19, including relief from in-person board meetings through June 15, 2020 and a 45-day extension for certain filing and delivery obligations that have original due dates on or before April 30, 2020. An affected entity must notify the SEC if it intends to rely on an order and must disclose such reliance on its website.

Affected funds and investment advisers that require additional assistance are encouraged to contact the SEC staff. The Commission continues to monitor the situation and may issue additional relief, if necessary. An affected entity must notify the SEC of its intent to rely on an order and must disclose such reliance on its website.

**Investment Company Act relief**

This [order](#) provides certain conditional exemptive relief under the Investment Company Act of 1940 to registered management investment companies, business development companies (BDCs), and any investment adviser or principal underwriter of such companies, as applicable, from the following provisions:

- In-person board voting requirements for the period from March 13 to August 15, 2020
- Filings on Forms N-CEN and N-PORT that are due between March 13 and June 30, 2020. The order provides an extended deadline as long as the form is filed no later than 45 days after its original due date.
- Transmittal of annual and semiannual reports to investors for the period from March 13 to June 30, 2020, provided the reports are transmitted no later than 45 days after their original due date and are filed within 10 days of their transmission to shareholders

Further, registered closed-end investment companies and BDCs are exempt from filing Form N-23C-2 at least 30 days prior to calling or redeeming securities during the period from March 13 to August 15, 2020.

**Investment Advisers Act relief**

This [order](#) provides conditional relief under the Investment Advisers Act of 1940 for registered investment advisers and exempt reporting advisers from filing amendments on Form ADV, from delivering Part 2 of Form ADV to existing clients, and from filing Form PF if the original due date is from March 13 to June 30, 2020. Affected entities must file or deliver such information no later than 45 days after the original due date.

**CorpFin disclosure guidance**

The SEC’s Division of Corporation Finance (CorpFin) issued CF Disclosure Guidance: Topic No. 9, *Coronavirus (COVID-19).* The guidance provides CorpFin’s views on disclosure and other securities law
obligations that entities should consider when preparing disclosure documents in relation to business and market disruptions caused by COVID-19.

CorpFin is monitoring how entities are disclosing the impact and risks of COVID-19 on their businesses, financial condition, and results of operations. CorpFin also recognizes that it may be difficult to assess the impact of COVID-19 at this time, but reminds entities that what management expects the future impact to be, how management responds, and how it is planning for COVID-19-related uncertainties can all be material to investors. As a result, entities should consider the need for related disclosures within the context of the federal securities law and other principles-based disclosure systems.

**Disclosing evolving impact of COVID-19**

Disclosing the impact of COVID-19 may be necessary or appropriate in certain sections of the disclosure document, such as in MD&A, the business section, risk factors, legal proceedings, disclosure controls and procedures, ICFR, and the financial statements. The guidance includes a non-exhaustive list of questions for entities to consider with respect to their present and future operations and the impact of COVID-19. CorpFin encourages disclosure that allows investors to evaluate the impact through the eyes of management.

CorpFin also reminds entities of the safe-harbor provisions in Section 27A of the Securities Act of 1933 and Section 21E of the Exchange Act in relation to the disclosure of forward-looking information about material developments, including known trends and uncertainties regarding COVID-19.

**Dissemination of information to investors**

CorpFin reminds entities to avoid selectively disclosing material information related to COVID-19; rather, the information should be distributed broadly. Further, the entity, its directors and officers, and any corporate insiders should refrain from trading in the entity’s securities prior to the distribution of any non-public material information.

**Reporting earnings**

CorpFin reminds entities of their obligations under Regulation S-K, Item 10, and Regulation G with respect to the presentation of non-GAAP measures, as well as recently issued Commission guidance on MD&A with respect to their presentation of any performance metrics. For entities considering the presentation of a non-GAAP measure to adjust for the impact of COVID-19, CorpFin reiterates that they should explain why management believes the measure is useful and how it helps investors to assess the impact of COVID-19 on the entity’s financial position and results of operations.

Additionally, the CorpFin guidance clarifies that if an entity issues an earnings release and its GAAP financial results are not available due to pending final adjustments related to the impact of COVID-19, CorpFin will not object to the entity reconciling a non-GAAP measure to preliminary GAAP results. However, a reconciliation to such preliminary results will not be permitted in periodic filings, which require GAAP financial statements.

The guidance also encourages entities to proactively identify and address financial reporting matters earlier than usual, such as the effects of COVID-19 on their assets, including the impairment of goodwill or other assets, which might require assistance from an expert.

**Disclosure of changes in ICFR**

CorpFin provided considerations regarding the disclosure of changes in ICFR under Regulation S-K, Item 308(c). In Form 10-Q or Form 10-K, registrants must disclose any change in ICFR during the last fiscal
quarter that has materially affected, or is reasonably likely to materially affect, the registrant’s ICFR. To the extent that changes are made or will be made to ICFR, the registrant considers its obligation to disclose such changes. This is true whether the changes are due to the remediation of an existing material weakness or as a result of other developments, such as changing work circumstances as a result of COVID-19.

E. CARES Act

In reaction to the effects of COVID-19, many countries are considering, or have already enacted, legislation providing stimulus and relief for affected entities and individuals. On March 27, President Trump signed into law the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), which is a $2 trillion relief package and includes a combination of tax provisions and other stimulus measures. The CARES Act broadly provides tax payment relief and significant business incentives, and makes certain technical corrections to the 2017 Tax Cuts and Jobs Act (TCJA).

Income taxes

A number of provisions in the CARES Act may have significant income tax accounting implications for entities, including changes to the measurement of deferred tax assets and liabilities, the realizability of deferred tax assets, or management’s assessment of uncertain tax positions. The impact of these items should not be evaluated in isolation, as there may be interplay between the various provisions under the CARES Act.

Key changes to corporate taxation under the CARES Act include

- Changes to net operating loss rules, including a technical correction to the TCJA
- Temporary changes to business interest expense disallowance rules
- Acceleration of corporate alternative minimum credit refunds
- Technical correction to allow accelerated deductions for qualified improvement property
- Modification of charitable contribution limitation
- Payroll tax relief

See NDS 2020-07 for a comprehensive discussion of the impact of the CARES Act on income tax provisions.

Troubled debt restructurings and the CECL model for banks

The CARES Act includes provisions that provide optional relief from certain accounting requirements related to

- Loan restructurings by creditors
- ASU 2016-13, Financial Instruments – Credit Losses: Measurement of Credit Losses on Financial Instruments, which introduced the CECL model into U.S. GAAP

This optional relief is only available to entities that qualify under the provisions of each respective section of the CARES Act. Whether an entity qualifies is a legal determination.
Impact on U.S. GAAP

On April 3, 2020, the SEC Chief Accountant Sagar Teotia released a statement in which he noted that the SEC staff will not object to the conclusion that an election to apply Sections 4013 and 4014 of the CARES Act by entities that are eligible for the narrow and temporary relief provided by those sections would be deemed to be in accordance with U.S. GAAP.

Loan restructurings

Section 4013, Temporary Relief from Troubled Debt Restructurings, of the CARES Act provides optional, temporary relief from certain accounting and financial reporting requirements that apply to a lender’s accounting for TDRs. Section 4013 states that a financial institution may elect to suspend either of the following requirements under U.S. GAAP:

- Guidance for loan modifications related to COVID-19 that would otherwise be categorized as a TDR
- Guidance regarding a determination that a loan modified as a result of COVID-19 is a TDR, including for impairment accounting purposes

This optional relief in Section 4013 is only available to financial institutions, including insurance companies as clarified by the Consolidated Appropriations Act, 2020.

The provisions in Section 4013, as amended by the Consolidated Appropriations Act, apply to restructurings of loans that were not more than 30 days past due as of December 31, 2019 and which occur between March 1, 2020 and the earlier of 60 days after the COVID-19 national emergency terminates and January 1, 2022. The restructuring of a loan, including a forbearance arrangement, an interest-rate modification, a repayment plan, and any other similar arrangement that defers or delays the payment of principal and interest, should be related to COVID 19. The exception in Section 4013 does not apply to any adverse impact on a borrower’s credit that is not related to COVID-19.

ASU 2016-13 and the CECL model

Section 4014, Optional Temporary Relief from Current Expected Credit Losses, of the CARES Act provides optional, temporary relief from applying the CECL model. Section 4014 states that no financial institution will be required to comply with ASU 2016-13, including the CECL methodology for estimating allowances for credit losses.

The optional relief in Section 4014 is only available to

- Insured depository institutions (as defined in Section 3 of the Federal Deposit Insurance Act)
- Bank holding companies
- Affiliates of insured depository institutions or bank holding companies
- Credit unions regulated by the National Credit Union Administration

The provisions in Section 4014, as amended by the Consolidated Appropriations Act, apply during the period beginning March 27, 2020 to the earlier of the first day of the eligible financial institution’s fiscal year beginning after the date when the COVID-19 national emergency terminates or January 1, 2022.

For more information, see Snapshot 2020-14, “CARES Act addresses TDRs and CECL for banks.”
F. Consolidated Appropriations Act, 2021 – tax considerations

The Consolidated Appropriations Act, 2021 (CCA) includes a $1.4 trillion extension of government funding, including provisions under the CARES Act, with nearly $1 trillion in new stimulus measures. The CAA was signed into law on December 27, 2020.

The tax provisions are a $328 billion combination of stimulus provisions, tax cut extensions, and other favorable tax changes solicited by both parties in Congress. The most significant tax stimulus provisions that could impact an entity’s financial statements are as follows:

- To reverse existing IRS guidance provided in Notice 2020-32 by allowing taxpayers to deduct expenses paid with forgiven PPP loan proceeds
- To extend an enhanced version of the employee retention credit through the first two quarters of 2021
- To retroactively expand the 2020 version of the employee retention credit under the CARES Act to include PPP loan recipients
- To allow businesses to deduct 100 percent of meals “provided by a restaurant” in 2021 and 2022, though the phrase is not clearly defined in the legislation
- To extend the sick pay and paid family leave credits enacted by the Families First Coronavirus Relief Act (FFCRA) through 2021
- To extend through 2021 the increased taxable income limit on corporate charitable deductions from 10 percent to 25 percent and contributions of food inventory from 15 percent to 25 percent

Grant Thornton insight: CAA impact on quarterly financial statements and fiscal year reporting

Entities may have reported the anticipated nondeductibility of expenses paid with PPP loan proceeds for tax purposes in either previous quarters or fiscal year-ends under earlier IRS guidance in IRS Notice 2020-32, which was issued on April 30, 2020. Those entities would record a benefit in the period that includes the enactment of the CAA, which is December 27, 2020. Entities with year-ends prior to the enactment may need to assess whether subsequent event disclosures under ASC 855-10-50 are warranted. Since PPP loan forgiveness is nontaxable, entities should record a permanent book-to-tax difference, which should be treated as a discrete item in the quarter when the forgiveness occurs.

Entities should also determine if any CAA amendments change their estimated effective tax rate and should record the cumulative effect of these changes in the quarter when the bill is enacted.

The CAA also extends many expiring tax provisions under various laws. See Grant Thornton’s Tax Legislative Update 2020-07 for more details on the extensions and new tax changes under the CAA.
matters addressed in the document. All relevant facts and circumstances, including the pertinent authoritative literature, need to be considered to arrive at conclusions that comply with matters addressed in this document.

Moreover, nothing herein shall be construed as imposing a limitation on any person from disclosing the tax treatment or tax structure of any matter addressed herein. To the extent this document may be considered to contain written tax advice, any written advice contained in, forwarded with, or attached to this document is not intended by Grant Thornton to be used, and cannot be used, by any person for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code.

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