Optional accounting expedients can make LIBOR transition easier

The London Interbank Offered Rate (LIBOR), which is referenced in approximately $350 trillion of contracts, is expected to be eliminated in 2021. This action comes in response to concerns about structural risks to interbank offered rates in general, but LIBOR in particular. Regulators in various jurisdictions around the world have been working to replace LIBOR and other interbank offered rates with reference interest rates that are supported by transactions in liquid and observable markets. Given the prevalent use of LIBOR, and other interbank offered rates expected to be discontinued, the volume of contracts that will have to be modified to replace these reference rates with alternative rates, and therefore be subject to U.S. GAAP on contract modifications, may be overwhelming for many entities. In addition, changes in a reference rate could affect the application of hedge accounting, and certain hedging relationships may not qualify as highly effective during the period of the market-wide transition to a replacement rate.

To ease the expected burden on financial reporting related to reference rate reform, the Financial Accounting Standards Board (FASB) recently issued Accounting Standards Update (ASU) 2020-04, Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting. The ASU provides temporary optional expedients and exceptions to U.S. GAAP on contract modifications, hedge accounting and other transactions. Our white paper, Optional accounting expedients can make LIBOR transition easier, provides additional information about reference rate reform and discusses the temporary optional expedients and exceptions provided by the FASB, as well as the circumstances under which an entity may elect those expedients and exceptions. Our white paper also discusses the effective date and transition guidance in ASU 2020-04, along with the sunset date for the temporary optional expedients (i.e., the date after which the optional expedients may no longer be applied).

Small Business Administration’s new FAQ on PPP loan forgiveness

We have updated our white paper, Coronavirus: Financial reporting considerations, to reference the new guidance provided by the Small Business Administration in its Paycheck Protection Program Frequently Asked Questions (FAQs) on PPP Loan Forgiveness. This guidance addresses a whole range of issues having to do with the forgiveness of PPP loans, such as completing the loan forgiveness application, determining whether payroll and non-payroll costs are eligible for loan forgiveness and assessing how the forgiveness amount may be affected by workforce reductions. For additional information about how to
account for PPP loans (including their forgiveness), as well as many other topics entities should consider when preparing financial statements affected by the coronavirus pandemic, refer to our white paper.

**Convertible instruments and contracts in an entity’s own equity**

The Financial Accounting Standards Board (FASB) recently issued Accounting Standards Update (ASU) 2020-06 to address the complexity of its guidance for certain financial instruments with characteristics of liabilities and equity. Changes in this ASU include the following, among others:

- Removing the accounting models that require beneficial conversion features or cash conversion features associated with convertible instruments to be recognized as a separate component of equity. Convertible instruments that continue to be subject to separation models are (a) those with embedded conversion features that are not clearly and closely related to the host contract, meet the definition of a derivative and do not qualify for a scope exception from derivative accounting and (b) convertible debt instruments issued with substantial premiums for which the premiums are recorded as paid-in capital.

- Adding certain disclosure requirements for convertible instruments.

- Amending the guidance for the derivatives scope exception for contracts in an entity’s own equity. Contracts primarily affected by this amendment are freestanding instruments, such as warrants, and embedded features that are accounted for as derivatives under the extant guidance because of failure to meet the settlement conditions of the derivatives scope exception related to certain requirements of the settlement assessment. The FASB simplified the settlement assessment by removing the requirements to (a) consider whether the contract would be settled in registered shares, (b) consider whether collateral is required to be posted, and (c) assess shareholder rights.

- Simplifying the diluted earnings per share calculation for certain situations.

The ASU, *Debt – Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging – Contracts in Entity’s Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity’s Own Equity*, is effective for public business entities that meet the definition of an SEC filer, excluding entities eligible to be smaller reporting companies as defined by the SEC, for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years. For all other entities, the ASU will be effective for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years. Early adoption is permitted, but no earlier than fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. An entity should adopt the guidance as of the beginning of its annual fiscal year.

**AUDITING**

**COVID-19: Conversations with audit committee chairs**

The Public Company Accounting Oversight Board (PCAOB) recently published a COVID-19 resource, *Conversations with Audit Committee Chairs: COVID-19 and the Audit*, as a result of its audit committee outreach efforts during its 2020 inspections. Given the unprecedented challenges to auditors, audit committees and issuers due to the COVID-19 pandemic, the PCAOB asked audit committee chairs how COVID-19 has affected financial reporting and the audit.

The resource summarizes common themes the PCAOB heard from audit committee chairs, including:

- Companies contending with new or increased risks associated with the effects of COVID-19 – Audit committees have identified risks related to financial reporting and the audit, including cybersecurity; employee safety and mental health; going concern; accounting estimates; impairments; international operations; and accounting implications of the Coronavirus Aid, Relief, and Economic Security Act.

- Increased risks associated with remote work by the issuer and the auditor.
Most audit committee chairs stated the transition to remote work was effective and that internal control over financial reporting was managed, maintained or adjusted as necessary. The resource includes examples of questions that audit committees have identified as helpful to discuss with their auditors in understanding risks or impact related to remote work, such as:

- Will additional time be needed to get the audit work done remotely?
- Does the audit plan need to be updated?
- Do fees need to be revisited?

Multiple audit committee chairs identified an increased risk of cyber-related incidents, such as phishing attempts and email security.

- Increased communications with the auditor – The majority of audit committee chairs have been communicating more frequently with their auditors as a result of the pandemic, particularly regarding the following topics:
  - Trends auditors are seeing across their client base, particularly those pertaining to industry peers;
  - Areas of the audit that may or will warrant increased attention due to the effects of COVID-19, as well as how the auditor plans to approach those areas;
  - Which disclosures may need to change as a result of COVID-19; and
  - Potential challenges to a timely completion of the audit.