Coronavirus: Financial reporting considerations

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Introduction

The effects of the coronavirus are evolving rapidly and are unique for each entity's circumstances. In addition to addressing the serious operational impacts of the coronavirus, it is important that all entities consider how the coronavirus affects their financial reporting. In this white paper, we offer an overview of several financial reporting matters (which is not intended to be all-inclusive) for consideration during this critical time.

CARES Act

A number of governments around the world have implemented measures that provide assistance to entities that are attempting to deal with the financial impact of the coronavirus pandemic. These programs may be in various forms, including, but not limited to, loans, grants or tax relief. One example of such assistance is the Coronavirus Aid, Relief, and Economic Security (CARES) Act, which was passed in the United States on March 27, 2020. Certain provisions in the CARES Act have been revised by: (a) the Paycheck Protection Program Flexibility Act of 2020, which was passed on June 5, 2020, (b) the Consolidated Appropriations Act, 2021 (2021 CA Act), which was passed on December 27, 2020, (c) the American Rescue Plan Act of 2021 (ARP Act), which was passed on March 11, 2021, and (d) the Infrastructure Investment and Jobs Act (the IIJ Act), which was passed on November 15, 2021. Certain provisions of the CARES Act (as revised) raised accounting issues, which are discussed in this white paper. For purposes of these discussions, references to the CARES Act are referring to the provisions of that Act as revised through November 15, 2021, unless otherwise noted.

For information related to coronavirus-related relief packages, including the CARES Act, see our resource center. A summary of the relief package included in the 2021 CA Act is provided in our publication, A business guide to the December coronavirus relief package. A summary of the funding and relief included in the ARP Act is provided in our article, President Biden signs American Rescue Plan Act of 2021. A summary of the IIJ Act is provided in our article, House passes infrastructure legislation; sends bill to President Biden.

Asset impairment

As a consequence of the significant deterioration in economic conditions associated with the coronavirus pandemic, careful consideration should be given to both financial and nonfinancial assets and the need to recognize impairment losses or increased allowances for credit losses (as required by the relevant accounting guidance). A high-level overview of the accounting guidance by asset type is discussed in the remainder of this section.

Many of the sections that follow discuss investment impairment or collectibility issues related to certain financial assets.

Equity securities

Upon the adoption of FASB Accounting Standards Update (ASU) 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, equity securities that are not subsequently measured at fair value through earnings are written down to fair value in accordance with ASC 321-10-35-3 if a qualitative assessment indicates that the investment is impaired and the fair value of the investment is less than its carrying value. We believe in many cases a qualitative assessment performed under current conditions will result in a conclusion that the investment is impaired, in which case management will need to determine the fair value of the investment to quantify the impairment loss. No consideration can be given to the fact that this impairment may be of short duration, and unlike the preexisting guidance discussed next, no consideration is given to whether the holder has the intent and ability to hold the security until it recovers.

Under the guidance in ASC 320-10-35 that was relevant to equity securities prior to the adoption of ASU 2016-01, consideration was given to the duration of the impairment, and only impairment that was

deemed to be *other than temporary* was required to be recognized. Additionally, impairment was recognized if the holder did not have the intent and ability to retain the equity investment for a sufficient period of time to allow for an anticipated recovery in fair value.

Equity method investments

For equity method investments, ASC 323-10-35-31 to ASC 323-10-35-32A is the relevant impairment guidance to consider and requires loss recognition for losses in value that are other than temporary. This guidance mentions a series of operating losses of an investee, the absence of an ability to recover the carrying amount of the investment, or inability of the investee to sustain an earnings capacity that would justify the carrying amount of the investment as examples of some (but not all) factors to consider in making this determination.

Debt securities, prior to the adoption of ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*

Before the adoption of ASU 2016-13 (for which the effective date is discussed in the next section), ASC 320-10-35 is the relevant guidance to consider when recognizing impairment or expected credit losses on debt securities that are not accounted for at fair value through earnings. Under ASC 320-10-35, impairment losses are recognized on individual debt securities that have a fair value that is less than their amortized cost basis if, as of the balance-sheet date, management has the intent to sell the security or more likely than not will be required to sell the security before the recovery of its amortized cost basis. Thus, careful consideration should be given to upcoming cash needs in this challenging economic environment when performing this analysis. (Refer also to the separate section that follows on sales of held-to-maturity [HTM] debt securities.) Additionally, expected credit losses are recognized on individual impaired debt securities if management does not expect to fully recover the amortized cost basis. Changes in credit ratings and adverse conditions are two of numerous factors noted in ASC 320-10-35-33F that should be considered when estimating whether a credit loss exists. Entities should be mindful that credit ratings on individual securities may not be up to date and reflective of current conditions.

Effective date of ASU 2016-13

ASU 2016-13 is effective for public business entities that are Securities and Exchange Commission (SEC) filers, except for entities eligible to be smaller reporting companies (SRCs) (as defined by the SEC), in annual reporting periods beginning after December 15, 2019, and the interim periods therein. However, when the CARES Act was passed in April 2020, it provided optional temporary relief to insured depository institutions from compliance with ASU 2016-13, and the 2021 CA Act extended the expiration date of this relief. The optional temporary relief (as revised) stipulates that no insured depository institution, bank holding company or any affiliate thereof is required to comply with ASU 2016-13, including the current expected credit losses (CECL) methodology for estimating allowances for credit losses, during the period beginning on the date of enactment of the CARES Act to the earlier of the first day of the fiscal year beginning after the national emergency terminates or January 1, 2022. It should be noted that this temporary optional CECL relief does not apply to entities that are not insured depository institutions, bank holding companies or affiliates thereof. For all other entities (e.g., private companies, entities eligible to be SRCs), ASC 326 is effective in annual reporting periods beginning after December 15, 2022, and the interim periods within those fiscal years.

To the extent an insured depository institution, bank holding company or any affiliate thereof deferred its adoption of ASU 2016-13 based on the optional temporary relief provided in the CARES Act, but would like to adopt prior to the extended expiration date provided by the 2021 CA Act, we understand that the SEC staff will not object to either of the following approaches:

- Adopting ASU 2016-13 on December 31, 2020, retroactive to January 1, 2020
- Adopting ASU 2016-13 on and as of January 1, 2021

Debt securities, subsequent to the adoption of ASU 2016-13

After the adoption of ASU 2016-13 (for which the effective date is discussed in the previous section), ASC 326, "Financial Instruments – Credit Losses," is the relevant guidance to apply to debt securities that are not accounted for at fair value through earnings. Namely, ASC 326-20, "Financial Instruments—Credit Losses – Measured at Amortized Cost," applies to HTM debt securities, and ASC 326-30, "Financial Instruments—Credit Losses – Available-for-Sale Debt Securities," applies to available-for-sale (AFS) debt securities.

- HTM debt securities: Under ASC 326-20, HTM debt securities and other investments carried at amortized cost (e.g., cash equivalents) are required to be evaluated on a collective basis with other assets within the scope of ASC 326-20 that have similar risk characteristics, when such other assets exist. Additionally, expected credit losses need to be recognized through an allowance for credit losses regardless of the relationship of the fair value of a security to its amortized cost basis. Refer to the additional discussion of the adoption of ASC 326-20 that follows in the context of loans and other receivables. The estimate of expected credit losses should include a measure for the expected risk of loss even if that risk is remote. As a consequence of this, the expectation is that circumstances in which an HTM security does not have an allowance for expected credit losses would be rare (e.g., securities of the U.S. government or its agencies). The concepts of *other than temporary* and *the intent or potential requirement to sell an HTM security* are no longer relevant to the consideration and recognition of expected credit losses. Chapter 6 of our publication, A guide to accounting for investments, loans and other receivables (our financial assets guide), provides additional information about recognizing expected credit losses on HTM debt securities upon the adoption of ASU 2016-13.
- AFS debt securities: Under ASC 326-30, AFS debt securities continue to be evaluated for impairment individually. Credit losses are recognized on individual securities that have a fair value less than amortized cost through an allowance rather than as a direct write-down to the amortized cost basis of the security, unless the *intent or more-likely-than not* requirement to sell exists. In determining whether a credit loss exists, consideration should no longer be given to the length of time the security has been impaired or to recoveries or additional declines in the fair value after the balance-sheet date. The concept of *other than temporary* is no longer relevant, and in light of current conditions, it will be more difficult to conclude qualitatively that credit losses are not present in an impaired AFS debt security, which will trigger the need for projecting expected cash flows to quantify and recognize expected credit losses. Chapter 4 of our financial assets guide provides additional information about recognizing expected credit losses on AFS debt securities upon the adoption of ASU 2016-13.

Loans and other receivables, prior to the adoption of ASU 2016-13

Before the adoption of ASU 2016-13 (for which the effective date is discussed in an earlier section), ASC 310-10-35 is the primary guidance to consider in recognizing impairment and an allowance for expected losses on loans, commitments to lend and other receivables. Under its provisions, incurred losses are recognized. Consideration typically is given to historical loss rates when estimating the period-end allowance, with adjustments made to the historical loss rates as necessary so that the loss rates on which the allowance is based are reflective of current conditions. These adjustments are particularly important in light of the current severe and dramatically different economic conditions.

Loans and other receivables, subsequent to the adoption of ASU 2016-13

After the adoption of ASU 2016-13 (for which the effective date is discussed in an earlier section), ASC 326-20 is the relevant guidance to consider when recognizing expected credit losses on financial assets measured at amortized cost, including loans, other receivables, contract assets and cash equivalents. It also applies to net investments in leases, reinsurance receivables and off-balance-sheet credit exposures. As noted in a preceding section, ASC 326-20 requires assets within its scope to be evaluated on a collective basis with assets that have similar risk characteristics. The estimate of expected credit losses should include a measure for the expected risk of loss even if that risk is remote. As a

consequence of this, the expectation is that circumstances in which an asset that is within its scope does not have an allowance for expected credit losses would be rare. Amongst other changes, ASC 326-20 requires life of asset expected, rather than incurred, losses to be recognized and consideration to be given to current conditions, as well as reasonable and supportable forecasts.

Chapter 6 of our financial assets guide provides additional information about recognizing expected credit losses on loans and other receivables upon the adoption of ASU 2016-13.

Inventories

Inventory production may be at severely diminished levels for certain entities as a consequence of forced business closures, reduced demand and other ramifications of the coronavirus pandemic. ASC 330-10-30-3 indicates that the amount of fixed overhead allocated to each unit of production should not be increased as a consequence of abnormally low production or idle plants. In other words, unallocated costs need to be expensed as incurred.

Additionally, ASC 330-10-35 addresses the subsequent measurement of inventory and requires losses to be recognized when the net realizable value of the inventory, or in some cases, the utility of the goods, is less than cost. In addition, losses are required to be recognized in a similar manner on firm purchase commitments related to goods for inventory.

Goodwill

Repercussions of the coronavirus pandemic could affect estimates of future cash flows and earnings, thereby materially affecting the measurement of fair value of a reporting unit and resulting in the need to perform an interim impairment test of goodwill. The unit of account when testing goodwill for impairment is the reporting unit (in cases in which the relevant private company accounting alternative has not been elected), which is an operating segment or one level below an operating segment. ASC 350-20-35-30 states, “Goodwill of a reporting unit shall be tested for impairment between annual tests 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.” Examples of such events or circumstances (i.e., triggering events) are discussed in our article, Interim goodwill impairment testing by SEC filers.

If these triggering events or other relevant events occurred, entities must consider to what extent they (along with any offsetting positive and mitigating events and circumstances) impact the fair value and carrying amount of their reporting units in order to determine whether interim impairment testing is required. This consideration is based on whether these events collectively cause it to be more likely than not that the fair value of a reporting unit is less than its carrying amount. Even private companies and not-for-profit entities that have elected to amortize goodwill on a straight-line basis are required to test for impairment when a triggering event occurs indicating the fair value of the entity (or reporting unit) may be below its carrying amount. However, the FASB has provided a goodwill impairment triggering event alternative for private companies and not-for-profit entities that allows them to perform the goodwill impairment triggering event analysis (and any resulting impairment test) required by ASC 350-20, “Intangibles—Goodwill and Other – Goodwill,” as of the end of each reporting period, whether an interim or annual reporting period. For additional information about this alternative, see our article, FASB provides goodwill impairment triggering event alternative. For the reasons discussed in that article, we believe the alternative will be of limited benefit to most private companies and not-for-profit entities, and as such, most of those entities will still need to perform their goodwill impairment triggering event analyses (and any resulting impairment tests) as of an interim reporting date.

The following is a list of additional resources related to testing goodwill for impairment during the coronavirus pandemic:

- Impact of COVID-19: Goodwill impairment considerations
- Qualitative assessment of goodwill impairment upon triggering event

- Goodwill impairment testing when carrying amount is trending downward
- Goodwill impairment: Reporting units with negative equity

Indefinite-lived intangible assets

Like goodwill, an indefinite-lived intangible asset is required to be tested for impairment annually and more frequently if events or changes in circumstances indicate that it is more likely than not that the asset is impaired. The unit of account when testing indefinite-lived intangible assets for impairment is generally the asset itself. Triggering events similar to those relevant for goodwill would have to be considered in relation to the indefinite-lived intangible asset to determine whether interim impairment testing is required.

Long-lived assets to be held and used

These assets include those within the scope of ASC 360-10-15, such as property, plant and equipment. The unit of account when testing long-lived assets to be held and used for impairment is the asset group, which represents the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities. An asset group almost always includes multiple assets. ASC 360-10-35-21 states, "A long-lived asset (asset group) shall be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable." The guidance lists examples of such events or changes in circumstances, including a significant decrease in the market price of a long-lived asset (asset group) and a significant adverse change in the business climate that could affect the value, among many others. If impairment testing is required at the same time as goodwill and (or) indefinite-lived intangible assets, the testing of indefinite-lived intangible assets must occur first, followed by long-lived assets to be held and used, with goodwill tested last. For further discussion, see our whitepapers, Snapshot: Accounting for impairment of goodwill and other long-lived assets and Impairment testing of long-lived assets classified as held and used.

Fair value

ASC 820, "Fair Value Measurement," indicates the objective of a fair value measurement is to determine the price at which an orderly transaction would take place between market participants under the market conditions that existed at the measurement date. While the effects of the coronavirus pandemic are causing market volatility, it would not be appropriate to disregard market prices at the measurement date, unless those prices are from transactions that are not orderly. ASC 820-10-35-54I and ASC 820-10-35-54J contain useful guidance for identifying transactions that are not orderly.

Sales of HTM debt securities

Entities that are considering liquidating or transferring debt securities designated as HTM for upcoming cash needs or other reasons are advised to give consideration to the changes in circumstances that are outlined in ASC 320-10-25 as being consistent (versus inconsistent) with HTM classification. As noted in ASC 320-10-35-8 and ASC 320-10-35-9, any sale or transfer of an HTM security that represents a material contradiction with the entity's stated intent, or a pattern of such sales occurring, will trigger a requirement to transfer any remaining HTM securities to AFS. An example of a change in circumstances that is consistent with HTM classification is a sale or transfer due to significant deterioration in the issuer's creditworthiness. As noted at ASC 320-10-25-4 and ASC 320-10-25-5, a sale in advance of deterioration in the creditworthiness of the issuer (e.g., sales based solely on industry statistics), as well as sales due to events such as liquidity needs and changes in market interest rates, are not consistent with HTM classification. ASC 320-10-25-9 indicates that certain sales or transfers that are caused by an event that could not have been reasonably anticipated will not necessarily call into question the entity's intent to hold other debt securities to maturity if the event is isolated, nonrecurring and unusual for the reporting entity. In light of the subjectivity inherent in determining what sales or transfers of HTM securities are consistent with classification as HTM, entities should give careful consideration to the guidance in ASC 320-10, "Investments—Debt and Equity Securities – Overall," and its specific facts and circumstances before

undertaking a sale or transfer that could taint the ability to maintain or use the HTM designation for other debt securities.

Lease considerations

Impairment

Right-of-use (ROU) assets recognized by lessees under ASC 842, “Leases,” are subject to the impairment guidance in ASC 360-10-35. ROU assets might become impaired as a result of business closures or reduced usage, among other things. Any ROU asset that becomes impaired should subsequently be measured at its post-impairment carrying amount less accumulated amortization. After the impairment, amortization of the ROU asset generally would be recognized on a straight-line basis (unless another basis is more representative of the pattern in which the lessee expects to consume the remaining economic benefits from its right to use the underlying asset).

For lessors, under both ASC 840, “Leases,” and ASC 842:

- The guidance in ASC 310-10-35 prior to the adoption of ASU 2016-13 (for which the effective date is discussed in an earlier section) and ASC 326-20 after its adoption should be used to assess the potential impairment of net investments in sales-type leases and direct financing leases.
- Consideration should be given to the preceding discussion on long-lived assets for potential impairment recognition on the underlying assets.

Operating lease receivables under ASC 842

For lessors that have adopted ASC 842, if the collectibility of lease payments is assessed as probable at the commencement of an operating lease, and the collectibility assessment subsequently changes, the lessor should apply the guidance in ASC 842-30-25-13. Using that guidance, the lessor should recognize a current-period adjustment to income for any difference between: (a) the sum of (1) the lease income that would have been recognized and (2) variable lease payments recognized as income and (b) the amounts that have been collected from the lessee to date.

Lease concessions

A number of lessees are experiencing reduced cash flow as a result of the pandemic. Many lessors are providing or have provided economic relief in the form of lease concessions to their lessees, either voluntarily or as a result of contractual obligations. The FASB staff Q&A, *Topic 842 and Topic 840: Accounting for Lease Concessions Related to the Effects of the COVID-19 Pandemic*, addresses whether lease concessions granted by lessors as a result of the coronavirus pandemic are required to be accounted for in accordance with the lease modification guidance in ASC 840 or ASC 842 (as applicable).

The FASB staff guidance indicates that both lessees and lessors may elect to not apply the modification accounting guidance in ASC 840 and ASC 842 to lease concessions granted as a result of the coronavirus pandemic, thereby eliminating the need to determine whether the terms of the lease explicitly provide for the possibility of such concessions. This election would only be permitted if the lease concessions result in the lease’s total cash flows being substantially the same as or less than the lease’s total cash flows prior to the concessions.

When a lessee or lessor elects to not apply the modification accounting guidance in ASC 840 and ASC 842 to lease concessions resulting from the coronavirus pandemic, the accounting applied to the concessions depends on whether they only affect the timing of the payments (i.e., the concessions only defer payments without making any substantive changes to the total lease payments). When only the timing of payments is affected by the lease concessions, the FASB staff acknowledges that multiple accounting methods may be applied in practice, none of which it believes would be preferable to the others. The two specific accounting methods discussed by the FASB staff would result in the deferred payments resulting from the lease concessions being accounted for as either:

- Increases to lessors' lease receivables and lessees' payables as the receivables and payables accrue, respectively. (Under this method, both lessors and lessees continue to recognize income and expense, respectively, as they otherwise would. This method accounts for the concessions as if no changes were made to the lease.)
- Variable lease payments by both lessees and lessors.

When a lessee or lessor elects to not apply the modification accounting guidance in ASC 840 and ASC 842 to lease concessions resulting from the coronavirus pandemic, and more than just the timing of the payments is affected by the concessions, the accounting for the concessions depends on the facts and circumstances. For example, if a lease concession results in a lease payment being forgiven or waived, it should be accounted for as a variable lease payment.

When a lessee or lessor decides to apply (rather than elect out of) the modification accounting guidance in ASC 840 and ASC 842 to lease concessions resulting from the coronavirus pandemic, if the terms of the lease explicitly provide for the possibility of lease concessions resulting from the coronavirus pandemic, the concessions are accounted for as variable lease payments. If the terms of the lease do not provide for the possibility of such concessions, the concessions are accounted for using the modification guidance. For an entity that has adopted ASC 842, the modification provisions of ASC 842 apply, and a lessor and lessee should apply the guidance in ASC 842-10-25-8 to ASC 842-10-25-18 to determine whether the modification should be accounted for as a separate contract or as a change to the existing contract. If ASC 842 has not been adopted, lessors and lessees must determine whether a new lease has been created, and if so, the accounting for any such new lease. This determination requires two tests. The first test determines whether the classification of the lease would have been different if the new terms had been in place at lease inception. If the classification would have been different, a new agreement is considered to have been created, and the second test is performed and determines the classification of the revised lease, as of the date of the revision in the lease terms. If the first test does not result in a new agreement, the accounting for the modification depends on whether the entity is the lessee or lessor and the classification of the lease (see ASC 840-10-35 for additional information).

Based on the FASB staff guidance, the election to not apply the modification accounting guidance in ASC 840 and ASC 842 to lease concessions granted as a result of the coronavirus pandemic should be made consistently for leases with similar characteristics and in similar circumstances. In other words, the election may be made on a portfolio-by-portfolio basis.

The FASB staff also indicated in their guidance that disclosures about material concessions and their accounting effects should be provided by both lessors and lessees.

Loan and debt modifications and classification

The business disruptions caused by the coronavirus pandemic have resulted in many entities experiencing cash flow issues and (or) difficulty in meeting debt covenants, which have, in turn, led to entities modifying their debt or obtaining waiver letters for covenant violations.

Classification by debtor

If there has been a covenant violation or other default at the balance-sheet date, debtors should consider whether the classification of long-term debt needs to be revised in accordance with ASC 470-10-45. Additional information about debt classification matters, including examples in which the borrower has violated a debt covenant at the balance-sheet date, can be found in our white paper, Fundamentals of debt classification (our debt classification white paper).

A debt classification issue that may arise for a debtor involves a revolving credit agreement (i.e., a revolver) with a fluctuating borrowing base, which is the maximum amount that can be borrowed under the revolver by the debtor and may depend on the carrying amount of one or more of the debtor's balance sheet accounts, such as accounts receivable or inventory. The calculation of the borrowing base and how

often it is reset depends on the terms of the revolver. When a revolver has a fluctuating borrowing base, the classification of its outstanding balance at the current balance-sheet date depends, at least in part, on whether that outstanding balance exceeds: (a) the borrowing base as of the balance-sheet date or (b) the expected borrowing base(s) at any reset date(s) within one year of the current balance-sheet date. Debtors should carefully consider the effects of the coronavirus pandemic on the calculation of their borrowing base as of the balance-sheet date, as well as those reset dates within one year of the balance-sheet date. Failure to consider any reductions in its borrowing base(s) due to the effects of the coronavirus pandemic on its operations and cash flows could result in the debtor classifying part of the revolver's outstanding balance as noncurrent, when it should be classified as current. Additional information about the classification of revolvers with and without borrowing bases can be found in Section B.5 and Examples C.6 to C.11 of our debt classification white paper, with Examples C.7 and C.8 specifically illustrating the classification considerations for revolvers with borrowing bases.

Modifications: Debtor accounting

To the extent changes are made to its existing debt arrangements, a debtor must first determine whether those changes represent a troubled debt restructuring (TDR) subject to the accounting requirements of ASC 470-60, "Debt – Troubled Debt Restructurings by Debtors," and if not, whether those changes represent a modification or extinguishment subject to the accounting requirements of ASC 470-50, "Debt – Modifications and Extinguishments." Additional information about determining the appropriate accounting model to apply when changes are made to debt, and about applying the appropriate accounting model to those changes, can be found in our publication, A guide to accounting for debt modifications and restructurings. In addition, in October 2020, the FASB issued a FASB Staff Educational Paper, Topic 470 (Debt): Borrower's Accounting for Debt Modifications, which includes a high-level summary and overview of ASC 470-50 and ASC 470-60 and several examples of changes being made to debt as a result of the coronavirus pandemic.

Modifications: Lender accounting

Lenders that are making modifications as a result of the coronavirus or otherwise will need to give consideration to ASC 310-40, "Receivables – Troubled Debt Restructurings by Creditors," in determining whether the modification is a TDR.[1] However, when the CARES Act was passed in April 2020, it provided temporary optional relief to lenders considered financial institutions with respect to their application of the TDR accounting model. The 2021 CA Act extended the expiration date of this relief and clarified that financial institutions include insurance companies. Under the relief, a financial institution may elect to suspend both of the following for qualifying modifications: (a) application of ASC 310-40 to loan modifications related to the COVID-19 pandemic that would otherwise be categorized as a TDR and (b) any determination of a loan modified as a result of the effects of the COVID-19 pandemic as being a TDR, including impairment for accounting purposes. For a modification to qualify for this relief, it must meet all of the following conditions:

- The modification was executed in response to adverse impact on the credit of the borrower that was related to COVID-19 (and not any other factors).
- The modification was executed on a loan that was not more than 30 days past due as of December 31, 2019.

[1] The FASB recently issued a proposed ASU, *Financial Instruments—Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures*, which would, among other things, remove the existing TDR recognition and measurement guidance from U.S. generally accepted accounting principles (GAAP) for entities that have adopted ASU 2016-13. For information about ASU 2016-13's effective date, refer to the "Effective date of ASU 2016-13" section earlier in this white paper. If finalized and adopted as proposed, all loan modifications would be accounted for based on the loan refinancing and restructuring guidance in ASC 310-20-35-9 through 35-11. For additional information about the proposal, see our article, Proposed ASU: ASC 326, Financial Instruments – Credit Losses.

- The modification was executed between March 1, 2020 and the earlier of January 1, 2022 or 60 days after termination of the national emergency concerning COVID-19 declared by the President (which reflects the extension of the relief's end date included in the 2021 CA Act).

Additionally, our article, Coronavirus: Interagency statement on loan modifications, provides financial reporting information relevant to TDRs, and while this information is also geared to supervised financial institutions, on March 22, 2020, the FASB issued a release indicating its agreement with this interpretation of the accounting literature on TDRs. Accordingly, entities that are not eligible to apply or that have elected not to apply the CARES Act to a modification or modifications also may find the interagency statement helpful when applying ASC 310-40. In addition, on December 1, 2020, representatives of the Chief Accountant's offices of the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation presented at the American Institute of Certified Public Accountants (AICPA) Online Update on Banks & Savings Institutions. Their presentation provided clarification as to the application of the aforementioned interagency statement on loan modifications. Additional information about these clarifications is provided in our article, COVID-19: Clarification on interagency statement on loan modifications.

To the extent a financial institution elects the relief provided in the CARES Act or the interagency statement, or a modification is not deemed to be a TDR, the guidance in ASC 310-20-35 should be applied to account for the modification.

Lenders may provide a loan payment holiday to borrowers affected by the coronavirus pandemic, which allows the borrowers to temporarily cease making payments without interest accruing during the holiday. When the application of U.S. GAAP to the specific facts and circumstances of the loan payment holiday do not result in a TDR or a new lending arrangement, but instead results in the application of the modification accounting model in ASC 310-20, "Receivables – Nonrefundable Fees and Other Costs," the FASB staff has indicated that either of the following two accounting models are acceptable with respect to accounting for interest income during the holiday:

- Interest income is recognized during the loan payment holiday using a revised effective interest rate that equates the modified debt's remaining cash flows to the current carrying amount of the debt. The revised effective interest rate is used prospectively over the remaining term of the debt.
- Interest income is not recognized during the loan payment holiday. Instead, interest income should be recognized based on the modified contractual terms of the loan. Recognition of interest income resumes at the end of the loan payment holiday.

We believe the model elected by a lender should be consistently applied and disclosed as its accounting policy.

The AICPA issued Q&A Section 2130.41, *Loan Restructurings Resulting in Periods with Reduced Payments—Determination of the Effective Interest Rate*, which addresses how to determine the effective interest rate for restructured loans that are neither required to be accounted for as TDRs nor new loans.

Insurance considerations

Careful consideration should be given to business interruption insurance policies to understand which losses are covered and which are excluded. ASC 450-30, "Contingencies – Gain Contingencies," addresses the recognition and disclosure of gain contingencies which, by definition, involve uncertainty as to the possible gain that will ultimately be resolved. Under its provisions, contingencies that might result in a gain should not be recognized. The ultimate recovery under a business interruption policy is highly judgmental and typically subject to substantial negotiations between the insured and the insurance company. Consequentially, business interruption insurance recoveries are generally not recognized until the proceeds are received or the insurer confirms the amount of proceeds to which the insured is entitled, such that the uncertainty is removed.

Obligations for exit or disposal costs and contingencies

Forced business closures and distressed economic conditions have led to and may continue to lead to workforce reductions and (or) consolidation, disposal or abandonment of certain facilities. Additionally, these factors, as well as others that include travel bans and prohibitions on large group gatherings, have led to, and many continue to lead to, contract terminations. ASC 420, “Exit or Disposal Cost Obligations,” addresses liability recognition for certain termination benefits, contract termination costs and other exit and disposal costs.

ASC 450, “Contingencies,” addresses recognition and disclosure of both gain and loss contingencies.

Revenue recognition

Variable consideration

Variable consideration can take many forms, including refunds, returns, discounts, rebates, performance bonuses, milestone payments, penalties, contract claims and price concessions. An estimate of the variable consideration to which an entity expects to be entitled should be included in the transaction price (and ultimately recognized as revenue) to the extent it is probable that its inclusion will not result in a significant reversal of cumulative revenue recognized when the uncertainty giving rise to the variability is resolved. The estimate of variable consideration must be reassessed each reporting period until the underlying uncertainty is resolved. An entity’s previous estimates of variable consideration may significantly change in the current environment. For example, there may be more product returns and resulting refunds than originally anticipated, the criteria for earning certain performance bonuses may no longer be likely to be met, or there may be unanticipated penalties incurred that would warrant a reduction to previously recognized revenue and may impact future revenue recognition.

Contract modifications

Contract modifications occur when the entity and its customer agree to add or change enforceable rights and obligations in the contract (e.g., changes to the contract’s scope and [or] price). The accounting model applied to a contract modification under ASC 606, “Revenue from Contracts with Customers,” depends on a number of factors, including the pricing of the modification, whether any new products or services added by the modification are distinct and whether any of the remaining goods or services are part of a partially satisfied single performance obligation. Depending on the facts and circumstances, a contract modification could be accounted for under ASC 606-10-25-12 and ASC 606-10-25-13 as: (a) a separate contract, (b) the termination of one contract and execution of a new contract (which results in prospective treatment) or (c) part of the original contract (which could result in the recognition of a cumulative catch-up adjustment). In the current environment, there may be significant contract modifications occurring involving changes in scope, price changes or a combination of both. When considering contracts in which price concessions are granted, entities will first need to evaluate whether that price concession is considered a change to variable consideration (in which case it would result in a change in the estimated transaction price) or a contract modification (in which case the contract modification guidance included in ASC 606-10-25-12 and ASC 606-10-25-13 would apply).

Collectibility

An entity must conclude that collection of substantially all of the amount to which it will be entitled in exchange for the goods or services that will be transferred to the customer is probable (i.e., likely to occur) in order to conclude a contract with a customer exists under ASC 606. An evaluation of collectibility is also required for existing contracts that previously were determined to meet the collectibility criterion if there is a significant change in facts and circumstances. An example of a significant change in circumstances related to whether collectibility continues to be probable is a significant deterioration in a customer’s credit risk and ability to access credit due to the loss of major customers. If this criterion is not met at contract inception or upon re-evaluation due to a significant change in facts and circumstances,

the entity should reassess the criteria in subsequent reporting periods (as necessary) to determine whether all of the criteria subsequently are met. Until this criterion (among others) is met, an entity must defer revenue (or stop recognizing future revenue in the case of a re-evaluation) until the three criteria noted at ASC 606-10-25-7 are met. While under typical circumstances an entity would meet this criterion when entering into a revenue contract and would not be required to re-evaluate this criterion for ongoing contracts, in the current environment heightened scrutiny should be placed on this evaluation. Refer to the previous discussions on loans and other receivables for a discussion pertinent to the recognition of an allowance for credit losses on accounts receivable and contract assets. Note that any allowance for credit losses recognized on accounts receivable and contract assets related to contracts re-evaluated and determined to no longer meet the collectibility criterion should result in the recognition of a credit loss, presented as an expense and not a reduction of revenue.

Revenue recognition over time

If an entity satisfies performance obligations over time, it must recognize revenue over time using the method that best measures the progress made in transferring control of the underlying goods or services to the customer. Output methods or input methods can be used to measure progress toward complete satisfaction of performance obligations, which is calculated at the end of each reporting period. The calculation is based on the amount of outputs or inputs to date and the estimated total amount of outputs or inputs necessary to satisfy the performance obligation. When using an input method to measure progress, such as a cost-to-cost method, any cost incurred that ultimately does not contribute to satisfying the performance obligation should be removed from both the numerator and denominator of the cost-to-cost measure in determining the revenue recognized. Costs that ultimately do not contribute to satisfying the performance obligation may be caused by significant unexpected inefficiencies in the entity's performance (e.g., wasted labor, material, other resources) that were not included in the entity's contract price. As the coronavirus pandemic continues to evolve, entities should consider whether these types of inefficiencies have been appropriately considered in applying an input method such as the cost-to-cost method for purposes of determining the amount of revenue that should be recognized over time.

Hedge accounting and derivative valuation

Factors such as reduced sales and supply chain and other disruptions associated with the coronavirus pandemic also could impact the continued application of hedge accounting. When hedging forecasted transactions, such as interest payments on variable-rate debt, sales or purchases of a specific commodity or sales or purchases that are denominated in a certain currency, ASC 815-30-40 requires hedge accounting to be discontinued if any criteria to apply hedge accounting are no longer met, including the criterion in ASC 815-20-25-15(b) that requires hedged forecasted transactions to be probable of occurring. Additionally, when the determination is made that it is probable that a hedged transaction will not occur within the originally documented time period (or the two-month period thereafter), generally amounts reported in accumulated other comprehensive income (AOCI) related to the hedging derivative must be immediately reclassified to earnings. ASC 815-30-40-4 provides an exception to the immediate reclassification for rare cases—when the existence of extenuating circumstances that are related to the nature of the forecasted transaction and that are outside the control or influence of the reporting entity cause the forecasted transaction to be probable of occurring on a date that is beyond the additional two-month period of time, immediate reclassification is not required. In its FASB staff Q&A, *Topic 815: Cash Flow Hedge Accounting Affected by the COVID-19 Pandemic* (the FASB staff ASC 815 Q&A), they indicate that delays attributable to the coronavirus pandemic qualify as one of those rare cases in which the timing exception applies. However, it must be emphasized that the timing exception only applies if the forecasted transaction remains probable of occurring over a time period that is reasonable considering the nature of the entity's business, nature of the forecasted transaction and magnitude of the disruption to the entity's business from the coronavirus pandemic. If at any time it is no longer probable that the forecasted transaction will occur within that reasonable time period, the timing exception would not apply, and the amounts deferred in AOCI related to the discontinued cash flow hedge would be immediately

reclassified into earnings and disclosed in the financial statements. Careful consideration should be given to the specific facts and circumstances in determining whether a delayed forecasted transaction qualifies for this timing exception.

In addition, ASC 815-30-40-5 indicates that a pattern of determining that forecasted transactions are probable of not occurring calls into question an entity's ability to accurately predict forecasted transactions and the ability to use cash flow hedge accounting in the future for similar transactions. Based on the FASB staff ASC 815 Q&A, they believe, because of the unprecedented nature of the coronavirus pandemic, it would be acceptable for management to conclude that missed forecasts related to the coronavirus pandemic need not be considered when determining whether the entity has exhibited a pattern of missing forecasts that would call into question its ability to accurately predict forecasted transactions, and thus, the ability to use cash flow hedge accounting in the future for similar transactions. Determining whether the missed forecast is related to the coronavirus pandemic requires judgment based on the applicable facts and circumstances. If an entity determines that a missed forecast is related to the coronavirus pandemic, it continues to account for those missed forecasts in accordance with ASC 815-30-40-5 and to disclose the associated amounts as required by ASC 815-10-50.

In a letter dated May 1, 2020, the International Swaps and Derivatives Association (ISDA) requested relief, similar to that discussed in the preceding paragraphs, from the SEC staff related to ongoing cash flow hedges in which the hedged forecasted transactions are interest payments that are expected to be delayed beyond the period specified in the hedge documentation due to the coronavirus pandemic. It is our understanding that the SEC staff indicated that it would not object to an entity continuing cash flow hedge accounting in this circumstance if, amongst other requirements, the hedge relationship remains highly effective and the hedged forecasted interest payments remain probable of occurring.

In addition to giving consideration to whether hedged forecasted transactions remain probable, entities also should be mindful of other potential impacts the market and economic conditions during the coronavirus pandemic could have on the effectiveness of accounting hedges, particularly where there are some differences in critical terms. Examples may include that the derivative and hedged item may have been linked to different commodities indices that were highly correlated in the past but are not highly correlated now. Another common example is variable-rate debt with a floor that is hedged through an interest rate swap that does not have a floor. The current low interest rate environment has exacerbated that difference in critical terms. Entities may find when performing their quantitative assessments of effectiveness under the time frames prescribed by ASC 815-20, "Derivatives and Hedging – Hedging—General," (generally, at a minimum quarterly) that certain hedges are no longer highly effective, in which case, hedge accounting should be discontinued. Additionally, entities that are assessing effectiveness qualitatively under ASC 815-20-35-2A may find that the conditions are such that the entity no longer can assert qualitatively that the hedging relationship was and continues to be highly effective. In that case, the quantitative method selected in the initial hedge documentation would need to be performed to determine if the hedge relationship remains highly effective.

As it relates to derivative valuation, entities are reminded of the need to incorporate the risk of nonperformance into derivative valuations to arrive at a fair value measurement that is consistent with ASC 820. This requirement applies to derivatives that are designated as hedging instruments and those that are not. While this requirement is not new, as a consequence of current economic conditions and the duress certain entities are under, nonperformance risk is generally expected to have a more significant impact on the valuation of a derivative, particularly for those contracts that are not fully collateralized on a daily basis by whichever party is in a liability position on that day. With forward contracts, such as interest rate swaps that potentially involve a two-way transfer of cash, the measurement should consider the risk of nonperformance of both parties to the contract.

Stock compensation

Share-based payment arrangements may include performance targets tied to an entity's operations (e.g., customer sales, revenues, annual earnings before interest, taxes, depreciation and amortization). Under ASC 718, "Compensation—Stock Compensation," entities are required to assess the outcome of the performance condition and update that assessment each reporting period. Compensation cost is recorded only if it is probable the performance condition will be achieved. *Probable*, as used in this assessment, means an event is likely to occur. Disruptions in operations caused by the response to the coronavirus pandemic may have resulted in a change to this probability assessment. Entities will need to carefully assess whether performance conditions are still probable of being achieved and adjust compensation cost accordingly.

As a consequence of the declines in operations or a downturn in the market, entities may also be considering changing the terms of share-based payment arrangements to allow for continued vesting in awards with performance conditions or to lower the exercise price for out-of-the-money options. Any amendments that impact the vesting, value or classification of share-based payment awards must be accounted for as modifications and could result in changes in the amount of compensation cost to be recognized.

Tax considerations

CARES Act tax provisions

The CARES Act included several significant provisions for corporations, including increasing the amount of deductible interest under section 163(j), allowing entities to carryback certain net operating losses (NOL), and increasing the amount of NOL that corporations can use to offset income. These changes may have significant effects on an entity's provision for income taxes, especially where entities have NOL or section 163(j) carryforwards and a valuation allowance against some or all of their deferred tax assets. RSM's Tax Alert provides more information regarding the changes and the accounting for the tax provisions of the CARES Act.

2021 CA Act tax provisions

One of the significant provisions of the 2021 CA Act is that it grants entities a tax deduction for expenses paid with the proceeds from PPP loans. Under previous law, while the proceeds from PPP loan forgiveness were not taxable, the loan forgiveness resulted in the loss of deductions for the expenses paid from PPP loan proceeds. The new law ensures that entities can now deduct the expenses paid from PPP loan proceeds. For more information, and an example of how to account for the tax implications related to expenses paid from PPP loan proceeds, see the "Deductibility of expenses paid with proceeds from PPP loans" section, which is included later in this white paper in the broader discussion of the borrower's accounting for PPP loans.

For discussion of the other tax-related provisions of the 2021 CA Act, refer to our tax alert, COVID-19 relief Act extends and improves many credits and incentives.

Tax law changes included in the period of enactment

Under ASC 740-10-45-15, entities should include the effects of any tax law changes in the financial statement period that includes the date of enactment, which was March 27, 2020 for the CARES Act tax law changes and December 27, 2020 for the 2021 CA Act tax law changes. Consideration should be given to the interim reporting requirements in ASC 740-270, "Income Taxes – Interim Reporting," (as relevant) to determine the estimated annual effective tax rate to apply.

Valuation allowances on deferred tax assets and cumulative losses in recent years

To determine whether a valuation allowance should be recognized for deferred tax assets under U.S. GAAP, entities need to discern whether it is more likely than not that some or all of their deferred tax

assets will not be realized. ASC 740-10-30 addresses this determination and requires consideration to be given to all available evidence, both positive and negative. ASC 740-10-30-23 emphasizes that the weight given to each piece of evidence should be commensurate with the extent to which it can be objectively verified, and specifically notes that a cumulative loss in recent years is a significant piece of negative evidence that is difficult to overcome.

While ASC 740 does not define how to determine whether a cumulative loss in recent years exists, most interpretive guidance generally uses a *three-year* convention. The three-year convention is described as pretax book income or loss from all sources (i.e., including discontinued operations and other comprehensive income or loss) for the current year plus the previous two years, adjusted for certain permanent differences. In addition to adjusting for permanent differences, the only other item that generally should be excluded from the computation of cumulative income or loss is the cumulative effect of a change in accounting principle. However, the impact of profitable discontinued operations and true one-time events should be carefully considered when evaluating the other positive and negative evidence.

The pandemic has had a negative financial impact on many industries. This negative impact will likely result in more entities being in a cumulative loss position. Significant judgment is required in considering the positive and negative evidence when determining whether a valuation allowance for deferred tax assets is necessary. The amount of weight given to the evidence must be commensurate with the extent to which it can be *objectively* verified. Because estimates of *future* income are inherently *subjective,* they are given *less* weight in the valuation allowance assessment than *objectively* verifiable negative evidence presented by cumulative losses.

Consolidation

ASC 810-10-35-4 provides examples of events that, if one occurs, requires reconsideration of whether a legal entity is a variable interest entity (VIE). In the current economic environment, an entity might incur significant losses, which might exceed expected losses as calculated under ASC 810, “Consolidation.” Incurring such operating losses generally does not trigger the requirement to reassess whether the entity is a VIE. However, it is possible that, in response to significant losses, an entity might take an action that constitutes a reconsideration event. For example, if a VIE refinances its debt or receives additional equity contributions from new or existing equity holders, that would require reconsideration of whether the entity is a VIE.

Additionally, ASC 810 requires reporting entities to continually reassess whether they are the primary beneficiary of a VIE. It is also possible that changes in circumstances arising from the coronavirus pandemic might result in changes to previous conclusions as to whether the reporting entity is the primary beneficiary of the VIE. For example, assume the entity in the example in the previous paragraph was considered a VIE prior to defaulting on its debt, and that the reporting entity is the primary beneficiary. As a consequence of the lender obtaining the ability to make the decisions that most significantly impact the economic performance of the VIE, the reporting entity likely no longer will be the primary beneficiary.

Government assistance

Paycheck Protection Program loans

Program overview

The CARES Act established the Paycheck Protection Program (PPP), which is administered by the U.S. Small Business Administration (SBA), to provide loans to qualifying entities. Under this program, a qualifying entity could apply to an SBA-approved lender for a federally guaranteed loan to help offset certain payroll and other operating costs (e.g., rent and utility costs). The loan and accrued interest, or a portion thereof, is eligible for forgiveness by the SBA if the qualifying entity meets certain conditions. The 2021 CA Act provided additional funding to the program and changed certain of its provisions. A summary of these changes can be found in our publication, A business guide to the December coronavirus relief

package. Among the changes made were allowing a qualifying entity to apply for a second PPP loan, and prohibiting publicly traded companies from being able to obtain a PPP loan.

The SBA has issued an Interim Final Rule that provides information about the loan forgiveness requirements and review procedures applicable to PPP loans. Section V(1)(c) of the Interim Final Rule indicates that the SBA may audit any PPP loan at its discretion until the end of the required document retention period for the loan. For PPP loans of more than $150,000, the required document retention period ends six years after the date the SBA forgave the PPP loan or the borrower repaid the PPP loan in full. For PPP loans of $150,000 or less, the required document retention period for certain PPP loan requirements is three years, and for other requirements is four years, measured from the date the borrower submitted its loan forgiveness application. As explained in Section V(1)(b) of the Interim Final Rule, the SBA may review any or all of the following when auditing a PPP loan:

- Whether the borrower qualified for the PPP loan
- Whether the PPP loan amount was appropriately calculated and the proceeds used for allowable purposes
- Whether the loan forgiveness amount was appropriately determined

It is important to note that the SBA has the right to audit a PPP loan up to the end of the required document retention period for that loan even if it previously forgave the loan. In other words, the SBA's forgiveness of a PPP loan does not eliminate the possibility of it auditing the loan during the document retention period.

The SBA's FAQ for PPP Borrowers and Lenders provides guidance to address borrower and lender questions concerning the implementation of the PPP. This FAQ is updated on a periodic basis, including on July 29, 2021 to reflect the SBA's discontinuance of the use of the Loan Necessity Questionnaire for purposes of determining whether the borrower was eligible for a PPP loan (for additional information, see our article, Withdrawal of SBA loan necessity questionnaire for PPP loans). After the July 29, 2021 update, Question 39 in the FAQ for PPP Borrowers and Lenders indicates that a First Draw PPP loan of any size may be subject to audit to determine whether the borrower was eligible for the loan.[2] Prior to the July 29, 2021 update, Question 46 in the FAQ for PPP Borrowers and Lenders indicated that when evaluating loan eligibility, any entity that together with its affiliates received First Draw PPP loans of less than $2 million would have been deemed to have made the required certification concerning the necessity of the loan request in good faith for purposes of being approved for the loan, except for self-employed individuals that report more than $150,000 in gross income on Schedule C of their Form 1040 when that income was used to calculate the PPP loan amount. (This safe harbor for certain loans only applied to the certification concerning the necessity of the loan request in good faith for purposes of being approved for the loan and not to whether the necessary conditions for forgiveness of the loan have been met.) With the July 29, 2021 update to the FAQ for PPP Borrowers and Lenders, Question 46 was removed. The scrutiny of an audit for First Draw PPP loans creates an incremental degree of uncertainty with respect to whether those loans will have to be repaid. In addition, the change in the 2021 CA Act that prohibits publicly traded companies from being able to obtain a First Draw PPP loan may be indicative of the heightened level of scrutiny publicly traded companies that already received a loan (from the original funding of the program) may experience if an audit is conducted to determine whether they truly qualified for the loan. Recipients of First Draw PPP loans must carefully consider all of the guidance published by the SBA in the context of their own facts and circumstances when assessing whether they qualified for the loan and whether they meet the necessary conditions for forgiveness of the loan by the SBA.

With respect to whether a borrower qualified for a Second Draw PPP loan, prior to issuance of the July 29, 2021 update to the FAQ for PPP Borrowers and Lenders, Question 46, as updated on March 3, 2021,

[2] See Questions 31 and 37 of the SBA's FAQ for PPP Borrowers and Lenders for liquidity considerations related to whether an entity qualifies for the loan.

indicated a borrower would have been deemed to have made the required certification concerning the necessity of the loan in good faith given that they must demonstrate that they have had a 25% reduction in gross revenues to obtain the loan. As explained earlier, Question 46 was removed from the FAQ for PPP Borrowers and Lenders with the July 29, 2021 update due to the discontinuance of the use of the Loan Necessity Questionnaire.

With respect to whether a borrower meets the conditions for loan forgiveness, the SBA provides guidance in its FAQ About PPP Loan Forgiveness, including (but not limited to) guidance about completing the loan forgiveness application, determining whether payroll and nonpayroll costs are eligible for loan forgiveness and assessing how the forgiveness amount may be affected by workforce reductions.

Based on all of the information provided by the SBA about PPP loans, it is clear that whether an entity qualifies for a PPP loan, and whether it meets the necessary conditions for forgiveness, requires careful consideration of the PPP requirements and the individual entity's facts and circumstances.

Borrower accounting

There is currently no specific guidance in U.S. GAAP that addresses the accounting when a business entity obtains a loan that is forgivable by a government entity. Based on the discussion in the remainder of this section, we believe the following accounting models should be considered by business entities and not-for-profit entities (as appropriate):

Fact pattern	Business entities	Not-for-profit entities
When the entity determines it did not qualify for the loan	ASC 470, "Debt"	ASC 470
When the entity does not expect to meet the conditions for some or all of the forgiveness of the loan	ASC 470 for the portion of the loan for which the entity does not expect to meet the forgiveness conditions (see next row for the portion for which the entity expects to meet the forgiveness conditions)	ASC 470 for the portion of the loan for which the entity does not expect to meet the forgiveness conditions (see next row for the portion for which the entity expects to meet the forgiveness conditions)
When the entity determines that it does qualify for the loan and expects to meet the conditions for forgiveness of the loan	ASC 470 or one of the following by analogy[3,4]: • International Accounting Standards (IAS) 20, *Accounting for Government Grants and Disclosure of Government Assistance* • ASC 958-605, "Not-for-Profit Entities – Revenue" • ASC 450-30	ASC 470 or ASC 958-605

We believe that accounting for a PPP loan as debt is acceptable for both business and not-for-profit entities, and certainly warranted when they expect to repay the loan or do not expect the loan to be

[3] In determining the appropriate guidance to apply, a business entity should consider its previous accounting policy for similar transactions (if any).
[4] The SEC staff's views are provided later in this section.

forgiven. In addition, when an entity is considering whether a model other than ASC 470 may be appropriate, it should carefully consider whether it qualifies for the loan and meets the necessary conditions for forgiveness of the loan by the SBA. This would include consideration of the possibility that PPP loans may be audited at the SBA's discretion to determine whether the borrower qualified for the loan or met the conditions for forgiveness of the loan. The subjective nature of the necessity determination may make it difficult for the borrower to determine if, upon audit, they will be required to repay the loan. In addition, the borrower needs to determine whether they met all eligibility requirements and the conditions for loan forgiveness even after the SBA has forgiven the loan given the period of time over which the SBA has the right to audit a PPP loan.

Because there is currently no specific guidance in U.S. GAAP that addresses the accounting when a business entity obtains a loan that is forgivable by a government entity, the SEC staff in the Office of the Chief Accountant were asked to specifically comment on whether they would accept a registrant's use of either of the following models to account for a PPP loan: (a) ASC 470 or (b) IAS 20 by analogy. Additional discussion of both of these approaches is provided later in this section. We understand that when considering these two models, the SEC staff made it clear that by providing their views, they were not commenting on whether a registrant is or is not eligible to receive a PPP loan. The SEC staff indicated they would not object to a registrant accounting for the loan as debt under ASC 470, nor would they object to a registrant concluding that a PPP loan is akin to a government grant and accounting for it by analogy to IAS 20, provided the registrant qualifies for the loan, and there is *reasonable assurance* that it will meet the conditions necessary for forgiveness of the loan by the SBA. For this purpose, the concept of *reasonable assurance* equates to *probable* as used in ASC 450. The SEC staff did not comment on other guidance that may or may not be appropriate for a registrant to apply when accounting for PPP loans.

The AICPA issued Q&A Section 3200.18, *Borrower Accounting for a Forgivable Loan Received Under the Small Business Administration Paycheck Protection Program*, to address accounting for PPP loans by borrowers that are nongovernmental entities. The guidance in the AICPA Q&A related to the accounting model(s) that should or may be applied in certain facts and circumstances is consistent with the discussion herein.

While there is no specific guidance in U.S. GAAP with respect to how business entities should account for forgivable loans, there is specific guidance for how not-for-profit entities should account for contributions (which include the forgiveness of liabilities) in ASC 958-605. Despite ASC 958-605 specifically excluding from its scope transfers of assets from government entities to business entities, at a meeting of the Private Company Council on April 17, 2020, the FASB staff noted that business entities are not precluded from applying ASC 958-605 by analogy when appropriate. As such, this guidance could potentially be applied by a business entity by analogy if the entity believes the liability will be forgiven. If that is not the case, the entity would account for the loan as debt under ASC 470. Additional information about ASC 958-605 is provided later in this section.

In addition to accounting for a PPP loan in accordance with ASC 470 or by analogy to IAS 20 or ASC 958-605, we believe it may also be acceptable for business entities to account for the forgiveness of the loan in accordance with the guidance in ASC 450-30, for which additional information is provided next.

Following is additional information about each of the accounting models discussed herein (refer to the preceding table for a summary of our thoughts on which entities may apply each model and under which circumstances):

- *ASC 470.* The amounts received under the loan are recognized as debt. Interest expense should be accrued and recognized on the loan in accordance with ASC 835-30, "Interest – Imputation of Interest." However, an entity should not impute interest based on a higher market rate (as otherwise required), because an exception to doing so is provided in ASC 835-30-15-3(e) when the interest rate is prescribed by a government agency. For derecognition purposes, ASC 470-50-40-1 refers to ASC

405-20-40-1, which indicates that a financial liability is not derecognized until it is either paid off by the debtor or the debtor is legally released as the primary obligor. For this purpose, a financial liability includes debt and any accrued interest. We believe the borrower has been legally released as the primary obligor for all or a portion of the PPP loan when amounts are remitted to the lender by the SBA in forgiveness of the PPP loan. (The lender is responsible for notifying the borrower of any remittances.) Any gain that should be recognized upon being legally released (because the loan and any accrued interest is forgiven in whole or in part) is presented in the income statement as a gain on the extinguishment of debt. For purposes of the cash flow statement, when the loan proceeds are received, they should be classified as a financing cash inflow. In addition, any portion of the loan forgiven should be deducted from net income when arriving at cash flows from operating activities using the indirect method. If the PPP loan forgiveness is not included as a separate line item in the operating activities section of the cash flow statement because it is aggregated with other line items, separate disclosure of that noncash financing activity would be necessary. Any portion of the loan repaid should be classified as a financing cash outflow, and any interest paid should be classified as an operating cash outflow.

- *IAS 20.* The loan is accounted for as a government grant by analogy to IAS 20, provided the business entity qualifies for the loan and there is *reasonable assurance* that it will meet the conditions necessary for forgiveness of the loan by the SBA. Under IAS 20, the forgivable loan would be considered an income grant. As an income grant, the amounts received under the loan should be reflected as a deferred income liability on the balance sheet and derecognized into income as the entity is incurring and recognizing the qualifying payroll and other operating costs. The income statement effects of an income grant are presented as either a separate line item, within other income (or a similar general line item) or net within the related expense line item (e.g., payroll expense). For purposes of the cash flow statement, a business entity should classify the loan proceeds that are probable of forgiveness as either a financing or operating cash inflow, depending on its interpretation of the guidance in ASC 230, "Statement of Cash Flows."
- *ASC 958-605*. Proceeds from the PPP loan should be accounted for as a conditional contribution and recognized as a refundable advance until the conditions for forgiveness have been substantially met or explicitly waived. The derecognition of the liability is reflected as contribution revenue (or other income, if appropriate) for a not-for-profit entity. When analogizing to ASC 958-605, we believe the derecognition of the liability for a business entity should generally be reflected in other income.
- *ASC 450-30*. Proceeds from the PPP loan should be recognized as a liability. A contingent gain is usually not recognized until all uncertainty is removed.

Given the lack of guidance that is directly on point, as well as the subjectivity and complexities in determining if an entity is eligible for a loan and if the relevant criteria are met to release the liability into the income statement, we recommend an entity discuss the model selected and its application of that model with its advisers and auditors.

The accounting considerations related to a PPP loan do not end upon forgiveness of the loan by the SBA, because whether a borrower truly qualified for a PPP loan and met the conditions necessary for forgiveness of the loan could be audited by the SBA up to six years after it forgave the loan (depending on the amount of the loan and the requirements being audited). As such, even after a PPP loan has been forgiven by the SBA, consideration should be given to the loss contingencies guidance in ASC 450 (both from a disclosure and recognition perspective) during the period of time the PPP loan is still subject to audit by the SBA. From a recognition perspective, if it is probable at the balance-sheet date that the borrower will have to repay any amount previously forgiven by the SBA, and the amount of the repayment is reasonably estimable, the borrower should recognize a contingent liability and provide the necessary disclosures about that liability. If it is probable at the balance-sheet date that the borrower will have to repay a PPP loan amount previously forgiven or otherwise derecognized, but the amount of the repayment is not reasonably estimable, or if it is only reasonably possible at the balance-sheet date that

the borrower will have to repay an amount previously forgiven by the SBA, the borrower should provide the necessary disclosures about that loss contingency. Unless the possibility of repayment after forgiveness of a PPP loan by the SBA is clearly remote, we strongly recommend a borrower consult with its advisers and auditors to discuss whether the recognition or disclosure of a loss contingency related to its forgiven PPP loan is necessary.

Any entity that obtains a PPP loan should provide clear and complete disclosure about the loan, including its terms, how the entity determined it was qualified to receive the loan, how the entity determined it met the conditions for forgiveness of the loan, and how the entity is accounting for the loan and presenting it in its financial statements. In addition, in November 2021, the FASB issued ASU 2021-10, *Government Assistance (Topic 832): Disclosures by Business Entities about Government Assistance*, which requires business entities to make certain annual disclosures about transactions with a government that are accounted for by applying a grant or contribution accounting model by analogy to other accounting guidance such as ASC 958-605 or IAS 20. The required disclosures include:

- The nature of the government assistance received
- The accounting policy applied to the government assistance
- The recognized amounts of government assistance and where those amounts are reflected in the balance sheet and income statement
- The significant terms and conditions of the government assistance, including any related commitments and contingencies

These disclosures are not required for in-scope entities until financial statements for annual periods beginning after December 15, 2021. However, early application is permitted.

SEC registrants should consider the effects of obtaining a PPP loan on other aspects of its filings with the SEC, including its risk factor and liquidity disclosures. For example, the SEC staff in the Office of the Chief Accountant indicated that if an SEC registrant would not have had the necessary cash flows to continue its operations without the PPP loan, it should disclose that fact. In addition, on June 23, 2020, the SEC staff in the Division of Corporation Finance issued Disclosure Guidance: Topic No. 9A, *Coronavirus (COVID-19) – Disclosure Considerations Regarding Operations, Liquidity, and Capital Resources* (CF Disclosure Guidance Topic No. 9A), to provide the staff's current views regarding disclosures about operations, liquidity and capital resources that SEC registrants should consider with respect to the business and market disruptions related to COVID-19, including disclosure considerations related to governmental financial assistance in the form of loans.

Because the administration of the PPP by the SBA is fluid, and its terms potentially subject to change as a result of future legislation, entities should monitor developments by referring to the Paycheck Protection Program page of the SBA's website and the SBA's FAQ for PPP Borrowers and Lenders and FAQ About PPP Loan Forgiveness.

Deductibility of expenses paid with proceeds from PPP loans

The 2021 CA Act (in addition to providing various economic stimulus measures) grants companies a tax deduction for expenses paid with proceeds from forgiven PPP loans. Under previous law, the forgiveness feature of the PPP loans meant that any expenses funded through forgiven PPP loans were nondeductible for federal income tax purposes.

As discussed earlier, the effect of any change in tax law is required to be reflected in a corporation's tax provision in the period of enactment. As a result, for calendar year-end corporations, the tax law change from the 2021 CA Act (i.e., granting deductibility for the expenses) should have been reflected in the fourth quarter of 2020. Calendar-year corporations that had not recognized the debt forgiveness for financial reporting purposes in 2020 could take the expense deduction in 2020 for expenses incurred in

that year and have a permanent tax difference (related to debt forgiveness income on the PPP loan) in 2021 when the loan forgiveness income is recognized.

However, fiscal year-end corporations (for example, September 30, 2020 fiscal year ends) had a somewhat more complicated tax provision than calendar year-end corporations. The additional complexity resulted from the covered expenses being incurred in a different accounting period (i.e., fiscal year 2020) than the enactment of the tax law change (fiscal year 2021). Because of the direct link between the nondeductible expenses, prior to the 2021 CA Act change, and the nontaxable income from the debt forgiveness (i.e., the amount of nondeductible expenses was equal to the amount of the debt forgiveness), we believe that the resulting difference should have been accounted for as a deductible timing difference in situations where the expenses were incurred in periods prior to recognition of the debt forgiveness income. Therefore, fiscal year-end corporations with expenses funded by forgivable PPP loans that had not yet been forgiven had a deductible timing difference related to those expenses, which resulted in the recognition of a deferred tax asset.

Lender accounting

Lenders of PPP loans have clear accounting guidance to follow. Namely, ASC 310-10, “Receivables – Overall,” addresses the general accounting for loans and other receivables and ASC 310-20 addresses the recognition and measurement of origination fees and costs.

Under ASC 310-10, a lender would account for the PPP loan as either held-for-sale or held-for-investment, based on its intention. Alternatively, a lender could elect the fair value option (FVO) to account for its PPP loans in accordance with ASC 825, “Financial Instruments.” The following is a summary of the initial and subsequent measurement for the possible classifications of PPP loans:

Classification	Initial measurement	Subsequent measurement
Loans held-for-investment	Amount lent plus deferred direct loan origination costs less the deferred origination fees received.	Amortized cost. The direct loan origination costs and fees are recognized over the term of the loan as a yield adjustment (interest income). If certain conditions are met, estimated prepayments can be used to shorten the term of the loan for the purpose of recognizing deferred costs and fees (see discussion later in this section).
Loans held-for-sale	Amount lent plus deferred direct loan origination costs less the deferred origination fees received.	Lower of amortized cost or fair value. The direct loan origination costs and fees are a component of the loan’s amortized cost basis and are not amortized, but rather impact the gain or loss on sale.
FVO	Fair value	Fair value

PPP loans will be settled by being repaid either by the borrower or the SBA. Until a PPP loan is settled, it should continue to be accounted for as an interest-bearing loan. A lender would generally not recognize

an allowance for loan losses for properly underwritten PPP loans because the SBA guarantees 100% of the principal and interest amounts.

For loans that are not accounted for at fair value, direct loan origination costs and fees are deferred as part of the amortized cost basis of the loan. Fees received from the SBA should be deferred in this manner. As discussed in ASC 310-20, direct loan origination costs and fees on loans classified as held-for-investment are generally recognized as a yield adjustment to interest income using the effective interest method over the term of the loan. However, due to their forgivable nature, a PPP loan may have an actual life that is shorter than its term. ASC 310-20-35-26 allows lenders to consider estimated prepayments when determining the amortization period for recognizing the loan origination costs and fees if the lender holds a large number of similar loans for which prepayments are probable and the timing and amount of prepayments can be reasonably estimated. We believe, in the case of PPP loans, loan forgiveness and payment by the SBA prior to the maturity of the loan should be considered a prepayment. This means that the lender can elect to recognize loan origination costs and fees over a time horizon that is shorter than the term of the loan if the conditions discussed in ASC 310-20-35-26 are met. Consideration should be given to ASC 450 to determine if a loss should be recognized for fees that may be subject to clawback (because, for example, the borrower was not eligible for the loan).

The AICPA issued the following guidance, which provides further information about the lender's accounting for PPP loans:

- Q&A Section 2130.42, *Classification of Advances Under the Paycheck Protection Program*
- Q&A Section 2130.43, *Consideration of the SBA Guarantee Under the Paycheck Protection Program*
- Q&A Section 2130.44, *Accounting for the Loan Origination Fee Received from the SBA*
- Q&A Section 2130.45, *Accounting for Loan Repayment or Forgiveness by the SBA*

Main Street Lending Program loans

Program overview

The CARES Act established the Main Street Lending Program (MSLP), under which eligible borrowers and eligible lenders entered into specific lending facilities authorized by the Board of Governors of the Federal Reserve System (the Federal Reserve Board or FRB). The lenders were able to transfer up to a 95% loan participation interest in an MSLP loan to a special purpose vehicle (SPV) established and funded by the U.S. Department of the Treasury (the Treasury) and operated by the Federal Reserve Bank of Boston. The MSLP ended on January 8, 2021 and was intended to provide low-interest loans to small- and medium-sized businesses and not-for-profit entities that were in sound financial condition prior to the coronavirus pandemic, but needed additional credit to maintain their operations and payroll during the pandemic. The original date for the SPV to stop purchasing loan participations from eligible lenders was December 31, 2020. However, that date was extended to January 8, 2021 as a result of the 2021 CA Act, but only for eligible loans submitted to the Main Street lender portal on or before December 14, 2020. Loans submitted to that portal after December 14, 2020 that were not purchased by the SPV prior to December 31, 2020, will not be purchased by the SPV.

An important difference between the PPP loans discussed in the preceding section of this white paper and the MSLP loans discussed in this section are that the MSLP loans are not forgivable and are full recourse.

The FRB has provided three frequently asked questions documents focused on MSLP loans (MSLP FAQs). One of those FAQs is for borrowers that are businesses and another is for borrowers that are not-for-profit entities. Each of those FAQs provides detailed information on a variety of important topics, including the following:

- The specific lending facilities available to businesses (three available facilities) and not-for-profit entities (two available facilities)
- The requirements that must be met to be considered an eligible borrower or an eligible lender
- The process in place to apply for an MSLP loan and the related operational details
- The terms and conditions included in an MSLP loan and the loan participation agreement between the lender and the SPV
- The certifications and covenants required of borrowers in connection with an MSLP loan
- The accounting by lenders for the transfer of participation interests to the SPV (which is further discussed in a later section of this white paper)
- The regulatory treatment of MSLP loans by lenders

The third of the three MSLP FAQs includes FAQs that continue to be relevant after the termination of the MSLP.

The accounting for MSLP loans by eligible borrowers and eligible lenders is discussed in the next two sections of this white paper. For purposes of these discussions, we have assumed that both the borrower and lender meet the MSLP's eligibility requirements.

Borrower accounting

Given that MSLP loans are not forgivable, the unique accounting issue that arises for borrowers with respect to the accounting model that should be applied to PPP loans does not exist for borrowers with respect to MSLP loans. In other words, borrowers that enter into an MSLP loan should account for that loan using the same guidance it would use to account for debt.

For the MSLP lending facilities that are new term loans, the borrower recognizes debt in accordance with ASC 470 and interest expense in accordance with ASC 835-30, the latter of which does not require imputing interest based on a higher market rate (as may be otherwise required) when the interest rate is prescribed by a government agency. For derecognition purposes, ASC 470-50-40-1 refers to ASC 405-20-40-1, which indicates that a financial liability is not derecognized until it is either paid off by the debtor or the debtor is legally released as the primary obligor. For this purpose, a financial liability includes debt and any accrued interest. Given that MSLP loans are not forgivable, we would generally expect the debt and accrued interest to be derecognized upon payment by the borrower.

For the MSLP lending facilities that increase an existing term loan or revolving credit facility between the borrower and lender, the borrower must evaluate the increase as it would evaluate any increase to an existing term loan or revolving credit facility. As such, the borrower would first consider the TDR guidance in ASC 470-60, and if a TDR does not exist, next consider the debt modification and extinguishment guidance in ASC 470-50. For additional information about accounting for changes made to debt, refer to our publication, A guide to accounting for debt modifications and restructurings.

Lender accounting

Lenders should generally account for loans originated under the MSLP using the same guidance they would use to account for any other loans.

If a lender transfers a participation interest to the SPV, the lender must apply the guidance in ASC 860, "Transfers and Servicing," to determine the appropriate accounting for the transfer of that interest. More specifically, the lender must determine whether the participation interest transferred to the SPV meets the definition of a participating interest in ASC 860-10-40-6A and whether the transfer meets all of the criteria for sale accounting in ASC 860-10-40-5 such that the transferred portion of the loan should be removed from the lender's balance sheet. Question I.5 in each of the aforementioned MSLP FAQs discusses accounting for the transfer of participating interests in MSLP loans to the SPV. One of the criteria in ASC

860-10-40-5 requires that the transferred financial assets have been legally isolated from the transferor—put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership. Our article, ASC 860 legal isolation criterion for sale of participation under MSLP, provides additional information about how this criterion could be evaluated based on discussions involving the American Bankers Association, RSM, other accounting firms and the SEC Office of the Chief Accountant. When determining whether the definition of a participating interest is met, careful consideration should be given to the unit of account and the implementation guidance that begins at ASC 860-10-55-17E when the participation relates to additional credit extended on an existing loan or credit facility. Conclusions reached on whether the additional borrowings are a separate unit of account from the preexisting borrowings can impact this determination.

When sale accounting is appropriate, the lender applies the guidance in ASC 860-20, "Transfers and Servicing – Sales of Financial Assets," and derecognizes a proportionate amount of the MSLP loan's carrying amount (based on the portion sold), recognizes any assets obtained or liabilities incurred (e.g., servicing asset or obligation if warranted) and recognizes a gain or loss on the sale.

When sale accounting is not appropriate, the lender accounts for the transfer as a secured borrowing in accordance with ASC 860-30, "Transfers and Servicing – Secured Borrowing and Collateral," which includes treating the fee payable to the SPV as a debt issuance cost and the servicing fees received as a reduction of the interest expense recognized for the secured borrowing.

Employee Retention Credit

Program overview

The goal of the Employee Retention Credit (ERC) program is to encourage employers to retain and continue paying employees during periods of pandemic-related reductions in business volume (for example, during partial or full shutdowns) even if those employees are not actually working, and therefore, are not providing a service to the employer. The ERC program was: (a) created under the CARES Act, (b) significantly modified, expanded and extended into the first two quarters of 2021 by the 2021 CA Act (see our article, Employee retention tax credit significantly expanded for 2021), (c) extended into the third and fourth quarters of 2021 by the ARP Act and (d) subsequently ended early for employers (other than those that are considered recovery startup businesses) after the third quarter of 2021 by the IIJ Act (see our tax alert, House passes infrastructure legislation; sends bill to President Biden). In addition, the Internal Revenue Service (IRS) has provided the following supplemental guidance about the ERC:

IRS supplemental guidance	RSM articles for additional information
Notice 2021-20	Guidance issued for employers claiming the Employee Retention Credit
Notice 2021-23	The IRS provides further guidance on the Employee Retention Tax Credit
Notice 2021-49	IRS enhances employee retention credit guidance for open questions
Notice 2021-65	IRS releases guidance on Q4 removal of employee retention credit
Revenue Procedure 2021-33	IRS issues employee retention credit gross receipt exclusion procedure

The IRS provides access to its supplemental guidance on the ERC on its website at FAQs: Employee Retention Credit under the CARES Act. While some of the guidance indicates that it is applicable to the ERC for qualified wages paid during a specific timeframe, many of the items covered in the guidance may apply to one or more additional timeframes as certain rules work the same for multiple timeframes. As a result, it is important to carefully review the IRS' supplemental guidance on the ERC and identify the guidance that is applicable to an employer's specific facts and circumstances.

Provided in the remainder of this section is high-level discussion of the following:

- How an employer determines whether it qualifies for the ERC
- How an employer calculates the amount of the ERC it may claim
- How the ERC and PPP loan programs interact
- How an employer actually receives the benefit of the ERC

Qualification

Determining the nature of the employers that are eligible for the ERC, as well as determining whether certain employers should be viewed in the aggregate, requires careful consideration of the IRS' supplemental guidance, such as that in Sections III.A and III.B of Notice 2021-20.

Through the second quarter of 2021, an employer must meet one of the following two criteria to qualify for the ERC:

- The employer's business was partially or fully suspended by government order due to the coronavirus pandemic.
- The employer's gross receipts declined by 50% for 2020 (20% for 2021) when compared to the same quarter in 2019 (2019 is used as the benchmark year for both 2020 and 2021).

Alternatively for 2021, an employer may elect to apply the gross receipts test by using gross receipts for the immediately preceding calendar quarter, compared to the corresponding calendar quarter in 2019. For example, to determine whether Company B is eligible for the ERC in the first quarter of 2021, Company B could elect to compare its 2020 fourth quarter gross receipts to its 2019 fourth quarter gross receipts.

For the third quarter of 2021, in addition to employers that meet one of the two criteria noted for the second quarter of 2021 qualifying for the ERC, an employer that is a recovery start-up business that opened for business after February 15, 2020 also qualifies for the ERC if it (a) does not have average annual gross receipts that exceed $1 million and (b) does not meet either of the two criteria noted for the second quarter of 2021. For the fourth quarter of 2021, only employers that are considered recovery start-up businesses that do not have average annual gross receipts that exceed $1 million are eligible to claim the ERC (without regard given to the two criteria noted for the second quarter of 2021). A recovery start-up business is limited to a total maximum credit of $50,000 per quarter for all employers.

Whether an employer qualifies for the ERC is often a complex determination that depends on careful consideration of the employer's specific facts and circumstances, the ERC program requirements and the supplemental guidance provided by the IRS. For example, determining whether a business would be considered to have a full or partial suspension of operations due to a governmental order requires careful consideration of the supplemental guidance provided by the IRS in Sections III.C and III.D of Notice 2021-20. For additional information about Notice 2021-20 and other IRS guidance, see our article, Guidance issued for employers claiming the Employee Retention Credit, as well as the other articles mentioned earlier in this section. Also, as discussed earlier, careful consideration should be given to the applicability of the IRS' supplemental guidance to the employer's specific facts and circumstances.

Calculation

For 2020, the amount of the credit is equal to the product of the employer's *qualified wages* paid (up to $10,000 of wages per employee paid after March 13, 2020, but before December 31, 2020) multiplied by 50%. For 2021, the amount of the credit is equal to the product of the employer's *qualified wages* paid (up to $10,000 of wages per employee per quarter) multiplied by 70%.

The definition of *qualified wages* depends on whether the employer is considered to be a *large employer*. For 2020, the definition of a *large employer* is averaging more than 100 full-time employees in 2019. For

2021, the definition of a *large employer* is averaging more than 500 full-time employees. Except as noted in the next paragraph, the *large employer* distinction is important in the determination of what constitutes qualified wages. For a large employer, qualified wages only include wages paid that are allocable to time *not* working by an employee. In contrast, for a small employer, qualified wages include wages paid to *all* employees, whether or not they were providing a service to the employer. For both small and large employers, qualified wages also include amounts paid for employee healthcare coverage.

For the third and fourth quarters of 2021 only, the ARP Act modified the definition of qualified wages for a *severely financially distressed employer* (defined as an employer that experienced a greater than 90% decline in gross receipts). However, as discussed earlier in this section, the IIJ Act changed the ERC for the fourth quarter of 2021 such that it is only available to employers considered recovery startup businesses (i.e., the ERC is no longer available to other employers in the fourth quarter of 2021). For a severely financial distressed employer, whether a large or small employer, qualified wages include *all* wages paid during the calendar quarter (i.e., not just those wages paid to employees who are not providing a service to the employer).

As mentioned earlier, for a recovery start-up business, the total maximum credit is capped at $50,000 per quarter per employer.

Determining the amount of ERC an employer may claim is often a complex calculation that depends on careful consideration of the employer's specific facts and circumstances, the ERC program requirements and the supplemental guidance provided by the IRS. For example, determining the amount of qualified wages used to calculate the ERC requires careful consideration of the supplemental guidance provided by the IRS in Section III.G of Notice 2021-20. For additional information about Notice 2021-20 and other IRS guidance, see our article, Guidance issued for employers claiming the Employee Retention Credit, as well as the other articles mentioned earlier in this section. Also, as discussed earlier, careful consideration should be given to the applicability of the IRS' supplemental guidance to the employer's specific facts and circumstances.

Impact of PPP loans

Employers that received PPP loans initially were not eligible for the ERC program. However, the 2021 CA Act retroactively eliminated that ineligibility so that employers who have PPP loans are now eligible to claim the ERC for qualified wages paid, but only to the extent that those wages were not paid with forgiven PPP loan proceeds. In other words, an entity may not claim the ERC for qualified wages paid with forgiven PPP loan proceeds.

Payment

An employer can receive an ERC benefit by requesting a refund on their quarterly employment tax returns or by amending employment tax returns filed for prior quarters. Through the second quarter of 2021, any anticipated credit can be utilized to reduce the employer's share of the Social Security payroll taxes due, as well as their required deposits of employee federal income tax withholdings. In the third quarter of 2021 for all qualifying employers and the fourth quarter of 2021 for qualifying recovery startup businesses, the anticipated credit is applied against the employer's share of the Medicare payroll tax due (rather than their share of the Social Security payroll tax). Any excess amount of the credit remaining after reducing these otherwise required payroll tax deposits can then be received as a direct cash payment from the federal government. As discussed earlier in this section, the IIJ Act changed the ERC for the fourth quarter of 2021 such that it is only available in that quarter to employers considered recovery startup businesses. Given that the IIJ Act was not passed until November 2021, employers no longer eligible for the credit may have already received an advance payment of the fourth quarter credit or reduced fourth quarter deposits in anticipation of a credit. The IRS provided guidance in Notice 2021-65 about those employers making adjustments for the taxes now owed for the fourth quarter that were not previously anticipated, which is discussed in our article, IRS releases guidance on Q4 removal of employee retention credit.

Financial reporting implications and analogy to IAS 20

The ERC is not an income-based tax credit (rather, it is a *payroll*-based tax credit). Therefore, the credits are not within the scope of ASC 740. Although the credits themselves are outside the scope of ASC 740, there are ancillary income tax accounting consequences. The IRS has indicated the following in their supplemental guidance referred to earlier:

- Receipt of the ERC is *not* included in an employer's gross income.
- Employers must reduce their deduction for salaries and wages by the amount of the ERC.

There is no specific guidance in U.S. GAAP regarding how business entities should account for the receipt of government assistance similar to the ERC. Entities should consider if they have a pre-established accounting policy for similar transactions, such as a PPP loan accounted for as a grant, that should be followed. In general, absent a different preestablished accounting policy, we believe it would be appropriate for business entities to account for the ERC by analogy to IAS 20. Analogies to other guidance (such as ASC 958-605 or ASC 450) may also be appropriate. Regardless of the accounting model applied, a business entity should clearly disclose its accounting policy and the impact to its financial statements. Not-for-profit entities should apply ASC 958-605 to account for the ERC.

When analogizing to IAS 20, if a business entity can demonstrate there is reasonable assurance (i.e., it is probable) that it has complied with all of the conditions required to qualify for the ERC and that it will be received, it would recognize the credit on a systemic basis over the periods the payroll expense for which the tax credit is intended to compensate the entity is recognized. Upon meeting the appropriate threshold, a receivable is recognized. If, as of the balance-sheet date, a business entity does not meet the recognition threshold in the guidance to which it is analogizing, the ERC benefit would not be recognized until such time, if any, that the recognition threshold is met. Under an analogy to IAS 20, the income statement effects of the ERC are presented as either a separate line item, within other income (or a similar general line item) or net as a reduction to salary and wages expense.

It may be necessary to recognize a deferred tax asset if wages expense is recognized earlier for financial reporting purposes than the ERC. While for tax purposes, neither the ERC nor the related wages expense are ever recognized, as discussed earlier in the "Deductibility of expenses paid with proceeds from PPP loans" section of this white paper, we believe that such a situation should be accounted for as a timing difference rather than as two separate permanent differences.

As discussed earlier in this section, complexities may be encountered in determining whether an employer qualifies for the ERC and calculating the amount of the ERC an employer may claim. As discussed in Answer 70 of Notice 2021-20, employers should create and retain certain records related to claiming the ERC.

Other government assistance

The accounting for government assistance is generally dependent in large part on the form of the assistance:

- Income tax credits are accounted for under ASC 740, "Income Taxes," as discussed in the "Tax considerations" section of this whitepaper.
- Loans generally are accounted for as debt under ASC 470 (see the previous two sections for discussion related to the accounting for PPP and MSLP loans).
- Contributions should be accounted for in accordance with ASC 958-605.
- Assistance that represents a payment for goods or services should be considered revenue and accounted for under ASC 606.
- Assistance that does not fall into any of the preceding categories generally is viewed as a government grant.

U.S. GAAP does not provide guidance on accounting by business entities for government grants. ASC 958-605 provides guidance for not-for-profit entities. As noted in the previous section discussing the borrower's accounting for PPP loans, despite ASC 958-605 specifically excluding from its scope transfers of assets from government entities to business entities, it may be appropriate for business entities to apply ASC 958-605 by analogy. Although, while the income-statement effects of a grant for a not-for-profit entity may be reflected as contribution revenue (or other income, if appropriate), the income-statement effects of a grant for a for-profit entity analogizing to ASC 958-605 should generally be reflected in other income. In certain cases, it may also be appropriate for business entities to analogize to IAS 20, which differentiates grants related to assets from grants related to income. Asset grants generally contain a primary condition that an entity qualifying for the grant purchase, construct or otherwise acquire long-term assets. When recognition of an asset grant is appropriate under IAS 20, it is recognized as either: (a) a deferred income liability (which is recognized in income on a systematic basis over the related asset's useful life) or (b) a reduction in the carrying amount of the related asset (which is recognized in income as the asset is depreciated). Income grants are grants other than those related to assets. When recognition of an income grant is appropriate under IAS 20, it is reflected in the income statement on a systematic basis that is consistent with the entity's recognition of the costs that qualify under the grant. Those income-statement effects are presented as either a separate line item, within other income (or a similar general line item) or net within the related expense line item for which the grant is intended to compensate the entity. Additional information about the guidance in IAS 20 applicable to income grants is provided in the previous section discussing the borrower's accounting for PPP loans.

All entities should carefully analyze the substance of any governmental assistance, as well as their compliance with conditions of the assistance. Because of the current lack of guidance in U.S. GAAP, entities should remain abreast of viewpoints that may be expressed by standard setters. In addition, where multiple accounting policies are deemed acceptable, we believe it is important for an entity to adopt a policy that is consistently applied to similar assistance programs, and to disclose its accounting policy. In addition, as discussed earlier in the "Paycheck Protection Program loans – Borrower accounting" section of this white paper, the FASB issued ASU 2021-10 in November 2021, which requires certain disclosures of in-scope entities that account for government assistance by analogy to other accounting guidance such as ASC 958-605 or IAS 20. These disclosures are not required until financial statements for annual periods beginning after December 15, 2021. However, early application is permitted.

In CF Disclosure Guidance Topic No. 9A, the SEC staff in the Division of Corporation Finance provided its current views regarding disclosures about the short- and long-term effects that governmental financial assistance will have on an SEC registrant's financial condition, results of operations, liquidity and capital resources, as well as the effects of that assistance on critical accounting estimates and assumptions.

Health-care specific government assistance

The AICPA issued a series of technical questions and answers related to how certain health care providers should account for government assistance provided under certain CARES Act provisions. Additional information about these technical questions and answers can be found in our article, Accounting for CARES Act provisions specific to health care entities. On September 19, 2020, significant developments occurred in that the U.S. Department of Health and Human Services (HHS) issued instructions for reporting on the use of Provider Relief Fund (PRF) distributions. Among other provisions, the HHS instructions placed new limitations on the permissible use of PRF distributions. On October 22, 2020, HHS amended its reporting instructions to modify how lost revenues should be calculated. The 2021 CA Act further modified the definition of lost revenues, allowing for the use of the difference between budgeted and actual revenue (subject to certain limitations). On January 15, 2021, HHS amended its reporting instructions to address the modifications resulting from the 2021 CA Act and certain other changes. On June 11, 2021, HHS amended its reporting instructions to address Skilled Nursing Facilities and Nursing Home Infection Control Distribution payments, and to extend the period of

availability of funds for all PRF distributions received subsequent to June 30, 2020. Among other provisions, the June 11, 2021 HHS guidance also delayed the required reporting for utilization of PRF distributions received after June 30, 2020 and extended the period to complete utilization reporting to 90 days (rather than 30 days). On July 1, 2021, HHS opened the PRF Reporting Portal and published a related User Guide and Frequently Asked Questions document. On September 10, 2021, HHS announced a 60-day grace period for providers to come into compliance with their PRF reporting requirements if they fail to meet the September 30, 2021 deadline for the first PRF reporting time period. Additionally, HHS continues to issue periodic updates to its PRF Frequently Asked Questions (FAQ). As of each reporting period end, it is important for reporting entities to give careful consideration to the financial statement ramifications of these and any additional PRF-related developments. Lastly, recipients of PRF funds are encouraged to review the Addendum to the 2020 Office of Management and Budget (OMB) Compliance Supplement (the 2020 Addendum) released in December 2020, as well as the 2021 OMB Compliance Supplement, as corrected on August 25, 2021. The 2020 Addendum addresses compliance requirements for recipients of PRF funds and an important change in the timing of the inclusion of PRF funds on the recipient's Schedule of Expenditures of Federal Awards (SEFA), as well as extended filing deadlines for PRF recipients' Single Audits. The 2021 OMB Compliance Supplement, as corrected, provides further clarifying requirements and guidance, including a delay in reporting of PRF funds in the SEFA for recipients with fiscal years ended December 31, 2020 through June 29, 2021, which is also addressed in the PRF FAQ, and guidance on defining the entity to be audited.

Shuttered venue operators and restaurant specific government assistance

The AICPA also issued Q&A Section 5270.01, *Recipient Accounting for Shuttered Venue Operators Grants and Restaurant Revitalization Fund Grants Received Under the Small Business Administration COVID-19 Relief Programs*, which discusses the accounting for the subject grants by both business entities and not-for-profit entities. For additional information, refer to our article, Recipient accounting for SVOG and RRF grants.

Going concern, risks and uncertainties

If conditions or events related to the coronavirus raise substantial doubt about an entity's ability to continue as a going concern within one year after the date the financial statements are issued (or available to be issued), certain financial statement disclosures are required under ASC 205-40, "Presentation of Financial Statements – Going Concern." Additionally, ASC 275, "Risks and Uncertainties," requires disclosures about risks and uncertainties including certain changes in estimates and vulnerability to concentrations that may be particularly relevant during the coronavirus pandemic.

In CF Disclosure Guidance Topic No. 9A, the SEC staff in the Division of Corporation Finance provided its current views regarding disclosures when there is substantial doubt about an SEC registrant's ability to continue as a going concern, including when the substantial doubt is alleviated by management's plans.

For additional information about management's responsibilities related to the going concern assessment, refer to our white paper, Going concern: Management's evaluation during coronavirus pandemic.

Reorganizations under the Bankruptcy Code

Due to the widespread and significant impact of the coronavirus pandemic on businesses, the number of bankruptcy filings increased significantly in 2020, and the effects of the pandemic could continue to be felt for years to come. That said, filing for bankruptcy may give entities the fresh start they need to continue to operate and grow in the future, unencumbered by significant debt or liabilities accumulated during the pandemic.

There are various forms of bankruptcy, but the one that is most commonly utilized by a business is referred to as a Chapter 11 proceeding. A Chapter 11 proceeding is a reorganization action, either voluntary or involuntary, initiated under the provisions of the Bankruptcy Code, which provides for a reorganization of the debt and equity structure of the business to allow the business to continue

operations. Entities undergoing a reorganization under Chapter 11 are within the scope of ASC 852-10, "Reorganizations – Overall." Our white paper, Accounting and reporting when in reorganization under Bankruptcy Code, provides accounting and financial reporting guidance for entities that have filed petitions with the Bankruptcy Court and expect to reorganize as going concerns under Chapter 11, as well as entities that have emerged from Chapter 11 under confirmed plans and are applying fresh-start accounting.

In some cases, a debtor may file a plan of liquidation under Chapter 11 or file a bankruptcy proceeding under Chapter 7, which results in a liquidation, voluntary or involuntary, initiated under the provisions of the Bankruptcy Code. Entities that liquidate or adopt plans of liquidation under the Bankruptcy Code should follow the guidance in ASC 205-30, "Presentation of Financial Statements – Liquidation Basis of Accounting."

Certain SEC and regulatory reporting considerations

The SEC has reminded entities to provide investors with insights regarding their assessment of, and plans for addressing, material risks to their business resulting from the coronavirus. In addition to financial statement disclosures, specific risks may need to be disclosed in an SEC filing as risk factors. Also, among other required disclosures in management's discussion and analysis of financial condition and results of operations, a registrant should describe any known trends or uncertainties that have had, or that the registrant reasonably expects will have, a material favorable or unfavorable impact on revenues or income. An entity may need to update previous disclosures to the extent that information becomes materially inaccurate.

On March 25, 2020, the SEC staff in the Division of Corporation Finance issued Disclosure Guidance: Topic No. 9, *Coronavirus (COVID-19)*, to provide the staff's current views regarding disclosure and other securities law obligations entities should consider with respect to COVID-19 and related business and market disruptions. SEC registrants also should keep in mind the requirement to disclose material changes in internal controls; for example, when preexisting controls can no longer be performed and (or) when new controls are put in place in response to necessitated operational changes resulting from the coronavirus pandemic.

On June 23, 2020, the SEC staff in the Division of Corporation Finance issued CF Disclosure Guidance Topic No. 9A to provide the staff's current views regarding disclosures about operations, liquidity and capital resources that SEC registrants should consider with respect to the business and market disruptions related to COVID-19. The SEC staff's views include a broad range of questions for SEC registrants to consider when determining the nature of the information they should disclose about the effects of COVID-19 on its operations, liquidity and capital resources (including the impacts of any related governmental financial assistance), as well as its ability to continue as a going concern.

GASB activities and resources

The Governmental Accounting Standards Board (GASB) has taken the following actions with respect to alleviating the financial reporting issues encountered by state and local governments due to the coronavirus pandemic:

- *Provided effective date deferrals.* The GASB issued Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, which postpones the effective dates of almost all GASB Statements and Implementation Guides that first became effective or are scheduled to become effective for state and local governments for periods beginning after June 15, 2018 and later. Statement 95 postpones the effective dates of many GASB Statements and Implementation Guides by one year, but also postpones the effective dates of Statement No. 87, *Leases*, and Implementation Guide No. 2019-3, *Leases*, by 18 months.
- *Released guidance about the accounting and financial reporting issues related to the CARES Act and coronavirus pandemic.* The GASB issued Technical Bulletin 2020-1, *Accounting and Financial*

Reporting Issues Related to the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) and Coronavirus Diseases. The Technical Bulletin includes guidance related to the accounting for and financial reporting of various matters related to the coronavirus pandemic, such as resources received from the Coronavirus Relief Fund and forgivable PPP loans.

In addition, on the GASB Response to COVID-19 page of its website, the GASB provides links to a number of stakeholder resources, including its GASB Emergency Toolbox, which helps stakeholders quickly identify the relevant guidance for a variety of accounting and (or) financial reporting issues that may be of particular relevance during the coronavirus pandemic.

Ongoing developments

The financial reporting considerations related to the coronavirus pandemic are continuing to evolve. This white paper will be updated periodically as developments warrant. For additional resources related to the coronavirus pandemic, visit our Coronavirus Resource Center.

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