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Financial Reporting Considerations Related to COVID-19 and an Economic Downturn

This publication was updated on January 11, 2021, to reflect certain provisions of the Consolidated Appropriations Act, 2021, that extend relief under the CARES Act related to troubled debt restructurings as a result of COVID-19. Text that has been added or amended since this publication's initial issuance has been marked with a ***boldface italic date*** in brackets. See Appendix E for a list of affected sections.

Executive Summary

The COVID-19 pandemic is affecting major economic and financial markets, and virtually all industries and governments are facing challenges associated with the economic conditions resulting from efforts to address it. For example, many entities in the travel, hospitality, leisure, and retail industries have seen sharp declines in revenues due to regulatory and organizational mandates (e.g., "shelter in place" mandates, school closures) and voluntary changes in consumer behavior (e.g., "social distancing"). To address these economic challenges, some governments are pursuing laws or other related initiatives. For example, in March 2020, the United States government enacted several new laws, most notably the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), which provides $2.2 trillion of economy-wide financial stimulus. See Deloitte's *Heads Up*, "Highlights of the CARES Act," for more information about the CARES Act and related financial reporting considerations. ***[Paragraph amended April 13, 2020]***

As the spread of the pandemic increases, entities are experiencing conditions often associated with a general economic downturn, including, but not limited to, financial market volatility and erosion of market value, deteriorating credit, liquidity concerns, further increases in government intervention, increasing unemployment, broad declines in consumer discretionary spending, increasing inventory levels, reductions in production because of decreased demand and supply constraints, layoffs and furloughs, and other restructuring activities. The continuation of these circumstances could have a prolonged negative impact on an entity's financial condition and results.

This *Financial Reporting Alert* discusses certain key accounting and financial reporting considerations related to conditions that may result from the COVID-19 pandemic as well as various industry-specific considerations. The significance of the topics discussed will of course vary by industry and entity, but we believe that the following accounting and reporting issues will be the most pervasive and challenging as a result of the pandemic's impact:

- *Preparation of forward-looking cash-flow estimates* — The use of forward-looking information is pervasive in an entity's assessment of, among other things, the impairment of nonfinancial assets (including goodwill), the realizability of deferred tax assets, and the entity's ability to continue as a going concern. Unique complexities associated with preparing forward-looking information as a result of the pandemic and economic downturn include the following:
    - There is an extremely wide range of possible outcomes. There is a particularly high degree of uncertainty about the ultimate trajectory of the pandemic and the path and time needed for a return to a "steady state."
    - The associated economic impact of the pandemic is highly dependent on variables that are difficult to predict. Examples include the degree to which governments restrict business and personal activities, the associated level of compliance by citizens, the degree to which "flattening the curve" is successful, and the nature and effectiveness of government assistance.
    - Each entity must then translate the effect of those macro conditions into estimates of its own future cash flows.

  Nevertheless, entities will need to make good-faith estimates, prepare comprehensive documentation supporting the basis for such estimates, and provide robust disclosure of the key assumptions used and, potentially, their sensitivity to change.
- *Recoverability and impairment of assets* — Perhaps the most acute examples of the increased challenge associated with forward-looking information are the impairment tests for long-lived assets, intangibles, and goodwill. These nonfinancial assets use recoverability and impairment models that rely on the development of cash flow projections that are subject to the significant uncertainties noted above. However, impairments establish a new cost basis for the assets and do not permit the subsequent reversal of the recorded impairment. Good-faith estimates in the current reporting period could result in material recorded impairments; if unforeseen favorable developments occur in subsequent quarters, the recognized impairment would no longer be indicated, but it cannot be reversed.
- *Accounting for financial assets* — Recently, there have been severe declines in the fair value of many financial assets, particularly equity securities. Likewise, the ability of debtors to comply with the terms of loans and similar instruments has been adversely affected. Entities will need to carefully consider and apply the appropriate impairment and loss recognition guidance.
- *Contract modifications* — Changes in economic activity caused by the pandemic will cause many entities to renegotiate the terms of existing contracts and arrangements. Examples include contracts with customers, compensation arrangements with employees, leases, and the terms of many financial assets and liabilities. As a result of

these changes, entities will need to ensure that the appropriate guidance in U.S. GAAP is considered.

- *Subsequent events* — It may be challenging for an entity to separate recognized and unrecognized subsequent events in a global marketplace that is extremely volatile and in which major developments occur daily (e.g., the stock market's daily reaction to new information). Although entities may not have all facts "on hand" on the balance sheet date, once such facts are gathered, an assessment must be based on conditions as they existed on the balance sheet date. For entities whose balance sheet date is in February or before, we believe that much of what is known about events related to COVID-19 as of the date of this publication for U.S. operations would be viewed as an unrecognized rather than recognized event (i.e., the information did not reflect conditions as of the balance sheet date). For example, during March 2020, (1) governments enacted "shelter in place" orders, (2) there was a precipitous drop in equity markets, and (3) sweeping restrictions to travel were initiated by corporations and governments. The severe negative impacts on the economy associated with these events were generally not existing conditions as of the end of February. As the global landscape evolves, entities are encouraged to remain vigilant, document the nature and timing of events, and consult with their accounting advisers.
- *Going concern* — As a result of COVID-19 and its associated effects, entities need to consider whether, in their specific circumstances, they have the ability to continue as a going concern within one year after the date on which the **interim** or **annual** financial statements are issued (or available to be issued, when applicable). The initial assessment (before consideration of management's plans) will require an entity to consider, among other things, (1) the extent of operational disruption, (2) potential diminished demand for products or services, (3) contractual obligations due or anticipated within one year, (4) potential liquidity and working capital shortfalls, and (5) access to existing sources of capital (e.g., available line of credit). An entity can only base this initial assessment on information that is available (i.e., known and reasonably knowable) as of the issuance date of the financial statements. An entity may be able to alleviate substantial doubt, if it exists, if it is probable that its plans will be effectively implemented, and, when implemented, will mitigate the conditions that are raising substantial doubt in the first instance and will do so within one year after the issuance date of the financial statements. Further, an entity must provide comprehensive disclosures in its annual and interim financial statements when events and conditions are identified that raise substantial doubt about the entity's ability to continue as a going concern even when management's plans alleviate such doubt.

Entities must carefully consider their unique circumstances and risk exposures when analyzing how recent events may affect their financial reporting. Specifically, financial reporting and related financial statement disclosures need to convey all material current or potential effects of the COVID-19 pandemic. It is also critical that management understand the risks entities face and how they are affected by them. Further, SEC registrants must consider whether to disclose information in areas such as MD&A or the risk factors section in addition to their disclosures in the footnotes to the financial statements. The remainder of this *Financial Reporting Alert* is intended to address these matters and is divided into the following sections:

- Select SEC and PCAOB Announcements Related to COVID-19
- SEC Reporting and Disclosure Considerations
- Broad Financial Reporting and Accounting Considerations
  - Requirement to Develop Estimates, and Consistency of Assumptions and Estimates
  - Impairment of Nonfinancial Assets (Including Goodwill)

    - Financial Instruments and Contract Assets
    - Revenue Contracts With Customers
    - Exit or Disposal Cost Obligations
    - Contingency and Loss Recovery Matters (Loss Contingencies, Recognition of Losses on Firmly Committed Executory Contracts, Future Operating Losses, Contractual Penalties, Insurance Recoveries)
    - Lease/Rent Concessions
    - Consolidation and Equity Method Accounting
    - Employee Benefits (Defined Benefit Plans, Stock Compensation, Employee Termination Benefits, Compensated Absences)
    - Risks and Uncertainties
    - Other Accounting and Reporting Considerations (Long-Term Intra-Entity Foreign Investments, Government Assistance, Income Statement Classification Considerations, Going-Concern Disclosures, Subsequent Events)
    - Income Taxes
- Internal Control Considerations
- Financial Reporting Under ASC 852 for Entities in Reorganization Under the Bankruptcy Code
- Appendix A — Industry-Specific Insights
    - Banking and Finance
    - Media and Entertainment
    - Real Estate
    - Oil and Gas
    - Power, Utilities, and Renewables
    - Aerospace and Defense
    - Life Sciences
    - Consumer
        - Transportation (Airlines, Shipping and Logistics, Passenger Ground Transportation)
        - Hospitality and Services (Hotels, Resorts, and Casinos; Restaurants and Food Services; Cruise Lines)
        - Retail
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- Appendix B — Entities Reporting Under IFRS Standards
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Select SEC and PCAOB Announcements Related to COVID-19

As the COVID-19 pandemic has evolved, the SEC and other regulators have provided guidance and offered companies regulatory relief as well as emphasized the importance of timely, high-quality financial reporting in the current environment. On April 8, 2020, SEC Chairman Jay Clayton and SEC Division of Corporation Finance Director William Hinman released a joint statement highlighting certain perspectives and providing considerations for public companies as they prepare for earnings releases and investor calls. The statement summarizes the guidance and relief the SEC has provided to date, much of which is discussed further below, and stresses the need for timely information regarding a company's financial and operating status as well as expectations for the future:

> Company disclosures should reflect [the] state of affairs and outlook and, in particular, respond to investor interest in: (1) where the company stands today, operationally and financially, (2) how the company's COVID-19 response, including its efforts to protect the health and well-being of its workforce and its customers, is progressing, and (3) how its operations and financial condition may change as all our efforts to fight COVID-19 progress.

The statement also highlights the importance of public companies' disclosures of forward-looking information regarding the economic recovery. In addition to providing important information to investors, such information may allow customers, suppliers, and other stakeholders to better plan for the future and help spur economic recovery. Chairman Clayton and Director Hinman also stated that they "would not expect good faith attempts to provide appropriately framed forward-looking information to be second guessed by the SEC" and reminded companies of the safe harbor available under U.S. securities law for such information. ***[Paragraph amended April 13, 2020]***

On April 3, 2020, and June 23, 2020, SEC Chief Accountant Sagar Teotia issued statements that focus on the importance of providing investors with high-quality financial information in light of COVID-19 and summarize the Office of the Chief Accountant's (OCA's) efforts to help registrants achieve this objective. Mr. Teotia reminded registrants that the OCA is available for consultation on complex matters and will continue to respect "well-reasoned judgments that entities have made." He also encouraged registrants to disclose information that is "understandable and useful" to investors regarding significant judgments and estimates. His statements highlight the OCA's engagement with other stakeholders in the financial reporting ecosystem and emphasize the importance of effective financial reporting and disclosure controls, appropriate disclosures about an entity's ability to continue as a going concern, and strong audit committee engagement and oversight. ***[Paragraph last amended July 1, 2020]***

Deadline Relief

[Section last amended September 18, 2020]

While the SEC has continually encouraged public companies to provide timely, high-quality information, it has also acknowledged that there may be instances in which registrants need additional time to gather that information. Consequently, on March 25, 2020, the SEC issued an order (the "Order") that gave public entities that meet certain conditions an additional 45 days from the original due date to file certain reports that would otherwise have been due from March 1 to July 1, 2020. On June 26, 2020, the SEC issued a joint statement indicating that with respect to the Order, the Division of Corporation Finance believed that "further extension of this relief [was] unnecessary" beyond the July 1, 2020, expiration date. Registrants that continue to be concerned that COVID-19 could negatively affect their financial reporting quality or ability to meet SEC filing deadlines are encouraged to proactively reach out to their auditors, legal counsel, or the SEC, as appropriate.

Disclosure Guidance

[Section last amended July 1, 2020]

In addition to the Order, the SEC's Division of Corporation Finance issued CF Disclosure Guidance Topic 9[1] ("DG Topic 9"). That guidance states, in part:

> **We understand that reporting companies share the view that timely, robust, and complete information is essential to functioning markets and that they want to file periodic and current reports in a timely manner, notwithstanding the available relief. The Division encourages timely reporting while recognizing that it may be difficult to assess or predict with precision the broad effects of COVID-19 on industries or individual companies.** [Emphasis added, footnote omitted]

On June 23, 2020, the SEC's Division of Corporation Finance issued DG Topic 9A[2] as a supplement to DG Topic 9. DG Topics 9 and 9A provide disclosure and other considerations associated with the evolving impact of COVID-19, including guidance on earnings releases, non-GAAP measures, and material nonpublic information (see separate discussions below).

Other Guidance and Relief

[Section last amended July 1, 2020]

The SEC has also provided the following COVID-19-related relief and guidance:

- *Material nonpublic information* — Because the potential effects of COVID-19 could constitute material nonpublic information, entities should consider how their codes of ethics and insider trading policies address, prevent, and deter trading that is based on such information. If an entity becomes aware of a material risk related to COVID-19, it should also consider whether and, if so, when to implement trading restrictions until it has appropriately informed investors. Further, on March 23, 2020, Stephanie Avakian and Steven Peikin, co-directors of the SEC's Division of Enforcement, issued a statement emphasizing that it is important for public companies "to be mindful of their established disclosure controls and procedures, insider trading prohibitions, codes of ethics, and Regulation FD and selective disclosure prohibitions to ensure to the greatest extent possible that they protect against the improper dissemination and use of material nonpublic information."
- *Investment funds and advisers* — The SEC issued two additional orders that give investment funds and advisers (1) relief related to the Investment Company Act of 1940 (which applies at least until December 31, 2020) and (2) relief related to the Investment Advisers Act of 1940 (which applied for reports due on or before June 30, 2020). The relief covers in-person board meetings and certain filing and delivery requirements.
- *Proxy rules and annual shareholder meetings* — The SEC published guidance to help public companies, investment companies, shareholders, and other market participants affected by COVID-19 comply with federal proxy rules for upcoming annual shareholder meetings by using technology, including virtual meetings, and the "notice-only" proxy delivery option. The SEC also issued C&DI 104.18 to clarify that in circumstances in which the filing of a definitive proxy statement is delayed, public companies may apply the Order to obtain deadline relief by filing a Form 8-K on or before July 1, 2020, and within 120 days of their year-end.
- *Manual signatures and submission of paper documents* — On March 24, 2020, the SEC staff issued a statement acknowledging that registrants may have difficulty obtaining manual signatures before filing electronically with the SEC. The statement also gives

[1] CF Disclosure Guidance Topic No. 9, *Coronavirus (COVID-19)*.
[2] CF Disclosure Guidance: Topic No. 9A, *Coronavirus (COVID-19) — Disclosure Considerations Regarding Operations, Liquidity, and Capital Resources*.

registrants certain conditional accommodations regarding such requirements in SEC Regulation S-T. Further, the SEC staff issued a statement on April 23, 2020, that allows certain forms that generally must be mailed to the SEC to be submitted electronically. Both statements may be applied until the SEC staff rescinds the guidance, with at least a two-week notice period.

To date, the SEC has issued over 50 different statements, orders, and pieces of interpretative guidance. For more information about the above actions as well as other SEC responses to COVID-19, see the SEC's COVID-19 Response Web site.

PCAOB Announcement Related to COVID-19

On March 18, 2020, the PCAOB announced updates to its operations in light of COVID-19. Changes include conducting remote inspections to the extent possible as well as cancelling in-person stakeholder events, such as audit committee and preparer roundtables, and holding virtual meetings instead. In addition, on March 23, 2020, the PCAOB announced that it would give "PCAOB-registered audit firms an up to 45-day relief period from inspections," with certain exceptions, and that it expects "to fully resume inspections beginning May 11, 2020."

SEC Reporting and Disclosure Considerations

[Section amended July 1, 2020]

The SEC expects registrants to clearly disclose material risks and uncertainties. As a result, most entities will need to disclose the impact of COVID-19 in various sections of their SEC filings, including the risk factors section, MD&A, the business section, legal proceedings, disclosure controls and procedures, internal control over financial reporting, and financial statements. In DG Topic 9 (issued March 25, 2020) as well as DG Topic 9A (issued June 23, 2020), the SEC staff provided a series of illustrative questions for registrants to consider when developing disclosures related to the current and expected future impact of COVID-19.

The SEC staff recognizes in DG Topic 9 that "[t]he impact of COVID-19 on companies is evolving rapidly and its future effects are uncertain." The questions in DG Topic 9 address topics such as a registrant's:

- Economic outlook.
- Operating results.
- Near- and long-term financial condition.
- Liquidity and capital resources.
- Debt or other financial obligations.
- Known trends and uncertainties.
- Significant judgments and estimates (e.g., impairments, restructuring charges, allowances for credit losses).
- Business continuity plans.
- Internal controls over financial reporting and disclosure controls and procedures.
- Human capital.
- Consumer demand.
- Supply chain matters.

DG Topic 9A provides additional questions for companies to consider in light of operational adjustments and financing arrangements they may have made or will make in response to COVID-19. The questions cover a broad range of topics but highlight a consistent theme: improving disclosures related to liquidity, capital resources, and going-concern considerations.

The SEC staff also observed that while registrants have provided disclosures about those matters primarily in earnings releases, they are encouraged to consider also disclosing such information in MD&A.

Questions that focus on **financial condition, liquidity, and capital resources** address matters such as:

- Recent financing transactions.
- Collateral or guarantee requirements.
- Access to credit lines and other unused sources of capital.
- Supply chain financing arrangements.
- Contract modifications that may affect a registrant's financial condition or liquidity (e.g., change of terms with lenders, lessors, tenants, suppliers, or customers).
- Changes to the cost of capital, credit ratings, planned capital expenditures (including human capital), share repurchases, and dividend payments.

Questions that focus on **CARES Act government assistance** address matters such as:

- The short- and long-term impact of any loan, grant, tax relief, or other assistance on a registrant's financial condition, liquidity, and capital resources.
- Material terms, conditions, or restrictions of any assistance.
- A company's ability to comply with such terms, conditions, or restrictions.
- Any expected changes to operations or finances when such terms, conditions, or restrictions no longer apply.
- Any significant estimates or uncertainties associated with the accounting for such assistance.

Questions that focus on **going concern** address matters such as:

- Conditions that may raise substantial doubt about a registrant's ability to continue as a going concern.
- A company's plans to address such conditions.
- A company's progress toward implementing those plans.

DG Topics 9 and 9A both encourage registrants to "provide disclosures that allow investors to evaluate the current and expected impact of COVID-19 through the eyes of management" and "proactively revise and update disclosures as facts and circumstances change."

The questions in DG Topics 9 and 9A are reproduced in full in Appendix D.

Risk Factors

Registrants must disclose information about the most significant risks facing the entity or its securities. While many registrants may already disclose their general risk related to issues such as potential natural disasters or pandemics, they should consider whether to update the disclosure to clarify that the risk is no longer hypothetical and to provide more specificity about the actual and potential future impact of COVID-19. In its Order (that provides conditional relief from filing deadlines — see discussion above), the SEC emphasized the importance of updating this disclosure and stated that a registrant must disclose "a company specific risk factor or factors explaining the impact, if material, of COVID-19 on its business."

MD&A

MD&A supplements the financial statements by providing information about a registrant's financial condition, results of operations, and liquidity. A registrant should discuss in its MD&A the material quantitative and qualitative impact of COVID-19 on its business. For example, the discussion could address potential issues such as changes in consumer behavior, including an unusual increase or decrease in demand, travel bans or limitations, store or facility closures, declines in customer traffic, the impact on distributors, increased competition for raw materials, supply chain interruptions, production delays or limitations, risk of loss on significant contracts, liquidity challenges or debt covenant issues, regulatory risks, or the impact on human capital.

In addition to discussing the impact on historical results, registrants are also expected to disclose in accordance with SEC Regulation S-K, Item 303, "any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact" on their financial condition, results of operations, or liquidity. These forward-looking disclosures are especially critical in connection with events such as the COVID-19 pandemic and the related economic uncertainty. Such disclosures can give investors an "early warning" about risks such as (1) when and under what conditions charges may be incurred in the future and the potential magnitude of such charges, (2) when revenue growth or profit margins may not be sustainable because of underlying economic conditions, or (3) when the registrant may be unable to comply with debt covenants or have other liquidity issues. As a result of the COVID-19 pandemic, liquidity may be significantly affected given the potential disruptions to normal levels of revenues and operating cash flows as well as to access to cash through debt or equity markets. In their MD&A disclosures about liquidity, registrants should consider discussing their working capital or other cash flow needs, anticipated changes in the amount and timing of cash generated from operations, the availability of other sources of cash along with potential limitations associated with accessing such sources, and the possible ramifications of their inability to meet their short- or long-term liquidity needs.

Connecting the Dots

[Added July 1, 2020]

DG Topic 9A was issued, in part, on the basis of the SEC's assessment of how companies have disclosed the effects of and risks associated with COVID-19 to date and, as discussed above, focuses strongly on liquidity, capital resources, and going-concern considerations. The guidance in DG Topic 9A encourages registrants to include material disclosures in MD&A as well as in earnings releases. As a result, we expect that the SEC will continue to focus on these disclosures in future filings.

Early-warning disclosures should also be considered by management in connection with accounting areas that require significant judgment, such as contingencies, valuation allowances, or potential impairments. These account-specific disclosures are frequently included as part of the critical accounting estimates section of MD&A, as discussed (with respect to goodwill impairment) in Section 9510 of the SEC's Financial Reporting Manual. Given the uncertainty associated with COVID-19, there is likely to be a substantial increase in the level of judgment entities need to apply in estimating future results and the potential range of reasonably likely outcomes. Registrants should therefore consider expanding their disclosures about (1) the key assumptions used in their most significant estimates and (2) the sensitivity of such estimates to changes that could reasonably occur as events associated with COVID-19 continue to develop. Consequently, registrants should consider updating, in their quarterly report on Form 10-Q, the critical accounting estimates previously disclosed in the Form 10-K to the extent that there have been material changes to key assumptions and estimates.

MD&A disclosures are typically included in a Form 10-K or Form 10-Q, but due to the rapidly evolving impact of COVID-19, registrants may also file current reports on Form 8-K to update investors on the current and potential future impact of COVID-19 on their business. Many of these filings have also announced that registrants are withdrawing or updating previously issued guidance related to expected 2020 revenue and earnings targets.

Earnings Releases

As a result of COVID-19, there may be circumstances in which complete GAAP financial information is not available at the time of an earnings release because of ongoing consideration of COVID-19-related matters. Registrants may choose to provide preliminary GAAP results that either include provisional amounts that are based on a reasonable estimate or a range of reasonably estimable GAAP results. Registrants should consider providing transparent disclosures that explain (1) why complete GAAP financial information is not available and (2) what additional information or analysis will be needed to complete it. Since earnings releases often include non-GAAP measures, registrants should consider the guidance in DG Topic 9 on the non-GAAP reconciliation requirements when complete GAAP information is not available (see the Non-GAAP Measures discussion below).

Non-GAAP Measures

[Section last amended July 1, 2020]

Registrants may also consider reflecting various impacts of COVID-19 in their non-GAAP measures. DG Topic 9 notes that if a registrant elects to do so, "it would be appropriate to highlight why management finds the measure or metric useful and how it helps investors assess the impact of COVID-19 on the company's financial position and results of operations." When using non-GAAP financial measures, a registrant must be aware of certain SEC requirements, including the rules in SEC Regulation G and in SEC Regulation S-K, Item10(e). In addition, the SEC staff has published a number of compliance and disclosure interpretations, which are updated periodically, to clarify its views on many non-GAAP presentation issues. The key requirements for disclosure of non-GAAP information in SEC filings, including press releases, are related to the following:

- *Prominence* — The most directly comparable GAAP measure should be presented with equal or greater prominence.
- *Reconciliation* — Registrants should present a quantitative reconciliation of the non-GAAP measure to the most directly comparable GAAP measure and should transparently describe all adjustments. In DG Topic 9, the SEC staff stated that if complete GAAP financial information is not available at the time of an earnings release because of on-going consideration of matters related to COVID-19, the staff would not object to a registrant's reconciliation of non-GAAP financial measures to the most directly comparable ***preliminary*** GAAP measure that reflects either "provisional amount(s) based on a reasonable estimate, or a range of reasonably estimable GAAP results." This position is limited solely to non-GAAP measures that have been provided to a registrant's board of directors to report financial results and does not apply to filings on Form 10-K or 10-Q. When relying on this position, a registrant "should explain, to the extent practicable, why the line item(s) or accounting is incomplete, and what additional information or analysis may be needed to complete the accounting."
- *Clear labeling* — Registrants should clearly label and describe non-GAAP measures and adjustments but should not, for example, use titles or descriptions that are either vague or confusingly similar to those used for GAAP financial measures. For example, instead of describing an adjustment as "Effects of COVID-19," a registrant should specify what the adjustment includes.

- *Usefulness and purpose* — Registrants should disclose why they believe the non-GAAP measure provides useful information to investors and, to the extent material, a statement disclosing how management uses the non-GAAP measure.

In addition to the prominence, reconciliation, clear labeling, usefulness, and purpose of such measures, an overarching theme of the guidance is that they should not be misleading, regardless of whether the measures are used in a filing (e.g., Form 10-K) or elsewhere (e.g., press release). As described in Section 100 of the C&DIs, non-GAAP measures that could potentially mislead investors may include those that:

- Exclude normal, recurring cash operating expenses necessary for business operations.
- Are presented inconsistently between periods (e.g., adjusting for an item in the current reporting period but not doing so for a similar item in the prior period without appropriately disclosing the change and explaining the reasons for it).
- Exclude certain nonrecurring charges but do not exclude nonrecurring gains (e.g., "cherry picking" non-GAAP adjustments to achieve the most positive measure).
- Are based on individually tailored accounting principles, including certain adjusted revenue measures.

Further, when evaluating whether a COVID-19-related adjustment is appropriate in a non-GAAP measure, a registrant should consider several factors including, but not limited to, whether the adjustment is:

- Directly related to COVID-19 or the associated economic downturn.
- Incremental to normal operations and nonrecurring (i.e., it is not expected to become the "new normal").
- Objectively quantifiable, as opposed to an estimate or projection.

Listed below are potential COVID-19-related adjustments that registrants might consider in their non-GAAP measures. While we have categorized the adjustments into three groups, each registrant must consider its own facts and circumstances in light of the SEC's rules and guidance. For example, an entity that has seen an increase in revenues because of COVID-19 may want to be cautious about adjusting for COVID-19-related costs. A registrant must also take into account the purpose and use of the resulting non-GAAP measure and the context in which it is presented. In addition to the examples below, see Deloitte's *A Roadmap to Non-GAAP Financial Measures and Metrics* for more information about SEC requirements and interpretations.

The categories of adjustments are as follows:

- ● Likely to be consistent with SEC requirements and interpretations.
- ▼ Proceed with caution; may not be consistent with SEC requirements and interpretations.
- ✕ Unlikely to be consistent with SEC requirements and interpretations.

Adjustments that **are likely** to be consistent with SEC requirements and interpretations include those related to:

- ● Impairment of goodwill, indefinite-lived intangible assets, and other long-lived assets.
- ● Contract termination costs (e.g., lease breakage costs).
- ● Facility or location shutdown costs.
- ● Cleaning costs (if they will be temporary and not become the "new normal").

- Employee-termination or other restructuring costs.
- Salary costs (e.g., hazard pay) to compensate for risk assumed by employees (if such costs will be temporary and not become the "new normal").
- Government grants or insurance recoveries.

Connecting the Dots

Certain provisions of the CARES Act may enable a registrant to obtain government grants to help mitigate many of the costs incurred during the pandemic, including those associated with items such as rent, utilities, and salaries. If a registrant obtains a grant (or other similar compensation) and also chooses to include an adjustment or adjustments for COVID-19 in its non-GAAP measure(s), it should consider adjusting its non-GAAP measure(s) for both the costs and corresponding grant income to avoid the appearance of "cherry picking."

Adjustments that **may not** be consistent with SEC requirements and interpretations include those related to:

- *Significant accounts receivable ("A/R") reserves* — Registrants may record A/R reserves that exceed historical levels if their customers have experienced COVID-19-related financial difficulties and liquidity issues. The following examples illustrate factors that a registrant might consider, among others, when evaluating adjustments to a non-GAAP measure for significant increases in A/R reserves:
  - A registrant has historically recorded an A/R reserve of 2 percent of revenue. During the pandemic, the registrant increases the A/R reserve to 5 percent as a result of increased customer liquidity concerns. While the registrant may consider whether the 3 percent increase is directly related to the pandemic, it may be difficult to determine whether a portion of the increase is incremental and objectively quantifiable or whether a portion may be indicative of the "new normal."
  - A registrant has written off a receivable (e.g., customer bankruptcy, terminated customer relationship), which may indicate that the amount is objectively quantifiable. Alternatively, a registrant's intent to continue pursuing collection may indicate that the amount may not be objectively quantifiable given the unknown outcome of such pursuit.

  A registrant should also be aware that revenues directly tied to the A/R reserves were (or will be) recognized and that a non-GAAP adjustment of such reserves could therefore be inconsistent with SEC requirements and interpretations.
- *Expected credit losses* — As a result of the effects of COVID-19 on a registrant's financial assets, the registrant may incur expected credit losses under the current expected credit losses (CECL) standard (ASU 2016-13[3]). In such a case, a registrant should carefully assess whether an adjustment is objectively quantifiable. For example, the registrant should consider whether it can differentiate between changes in expected credit losses for financial assets that are (1) directly related to COVID-19 and (2) attributable to other market factors and conditions.

Connecting the Dots

As a result of adopting the CECL standard, entities will recognize impairment of financial assets at the end of each reporting period on the basis of an expected losses model rather than the previous incurred loss model. Entities that adopt the CECL standard may want to disclose losses under the incurred loss model. For such entities,

[3] FASB Accounting Standards Update (ASU) No. 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.*

disclosing losses under the incurred loss model is allowable during the fiscal period in which the standard is adopted. However, it would not be appropriate to present non-GAAP measures of profitability or liquidity that are based on the non-GAAP incurred loss amounts.

- *Unprecedented markdowns* — A registrant whose inventories are seasonal or subject to expiration may be required to record unprecedented markdowns for slow-moving or obsolete merchandise. Since markdowns are typically recurring costs that vary on the basis of multiple factors, a registrant should consider whether it can differentiate between a markdown that is directly related to COVID-19 and one that is attributable to other market factors and conditions.

  In addition, determining whether an adjustment is objectively quantifiable could be complicated as a result of uncertainties associated with the ability to sell a product on a future date. For example, a retailer may mark down slow-moving merchandise but still expect to sell that merchandise in a subsequent period for a price that could vary on the basis of several market conditions. Alternatively, a restaurant owner may write off the cost of spoiled food inventory because of the unexpected closure of its restaurants.

- *Depreciation of idled facilities* — A noncash cost, depreciation expense is a common adjustment in some non-GAAP measures (e.g., EBITDA). Although depreciation expense incurred on an idled facility may be directly related to the pandemic and objectively quantifiable, it is not incremental (i.e., a registrant would have incurred depreciation expense regardless).

- *Furloughed employees and other related payments to idle employees* — Although compensation may be paid to idled, salaried employees during the pandemic, such cash costs generally are not incremental because they have historically occurred and are expected to be incurred in the future. Alternatively, a registrant may elect to compensate hourly employees for hours not worked, in which case the registrant may consider whether an adjustment is warranted since the compensation may be (1) incremental to the normal practice of compensating hourly employees only on the basis of hours worked and (2) directly related to COVID-19. However, a registrant should also consider that such "voluntary" compensation is not incremental to historical activity and therefore may reflect expected levels of compensation to be incurred after COVID-19.

Adjustments that **are unlikely** to be consistent with SEC requirements and interpretations include those related to:

- *Estimated lost revenue or profit* — Amounts cannot be objectively quantified (i.e., the estimate is not an actual cost or benefit).
- *Nontemporary increases or decreases to salary* — Expenses will become part of the registrant's "new normal."
- *Excess overhead* — Costs may need to be expensed immediately as opposed to being capitalized into inventory because of abnormally low production. Typically, such overhead expenses are not incremental and may include recurring cash costs.

Additional Considerations Related to Changes to Non-GAAP Measures

Any new adjustments or changes to non-GAAP measures related to COVID-19 should be clearly labeled, and changes to such measures should be transparently disclosed. Also, a registrant should be consistent in its presentation of non-GAAP measures between periods. Accordingly, when a non-GAAP measure is initially used or subsequently modified, a registrant should consider whether the adjustment(s) materially affected prior periods. If a new adjustment for an item in the current reporting period also occurred in the prior period, the registrant should consider retrospectively adjusting the prior-period non-GAAP measure for

consistency purposes. In addition, if new adjustments to non-GAAP measures are added as a result of COVID-19, an entity should ensure that its disclosure controls and procedures address the assessment and approval of the revised non-GAAP measures, including the consistency of presentation between periods and transparent disclosures about any changes.

Connecting the Dots

A critical aspect of such disclosure controls and procedures is the involvement of the appropriate levels of management and those charged with governance. Depending on the registrant, this may include reviewing — with a disclosure committee or the audit committee or both — the selection and determination of any new adjustments or non-GAAP measures.

Alternatives to Non-GAAP Measures

Given the potential challenges associated with many of the adjustments discussed above, a registrant may determine that transparent disclosure in MD&A may more effectively inform investors about certain COVID-19-related impacts than non-GAAP measures. For example, if a registrant elects to provide disclosures that simply quantify the estimated impact of COVID-19 on financial statement line items without adjusting the registrant's GAAP results (i.e., without establishing new totals or subtotals), those disclosures are not considered non-GAAP measures. If a registrant provides disclosure that does not adjust a GAAP measure but instead describes unusual or significant activities that occurred during the period, the disclosure would not be subject to the SEC's requirements and interpretations related to non-GAAP measures. When presenting disclosure alternatives, a registrant should disclose individually material COVID-19-related impacts separately.

As noted below, a company may consider presenting certain impacts of COVID-19 in a separate line item or line items in its statement of comprehensive income. We believe that if a company also intends to adjust for COVID-19-related amounts as part of a non-GAAP measure, each component of the COVID-19-related line item(s) would need to be assessed separately for compliance with non-GAAP reporting requirements (e.g., simply adding back the entire line item(s) may not be appropriate).

Metrics and KPIs

Many registrants disclose the metrics and KPIs used to manage their business. To provide guidance on such disclosures, the SEC issued an interpretive release that became effective on February 25, 2020. Existing metrics and KPIs may be affected by the COVID-19 pandemic, and registrants may establish new metrics related to its impact. For example, the same-store sales metric, which is used throughout certain industries, could be significantly affected by COVID-19. As a result, registrants may need to provide additional disclosures or reassess the usefulness of that metric. In addition, given the importance of liquidity in the current environment, the SEC staff acknowledged in DG Topic 9A that new or updated metrics may also include "cash burn rate" or "daily cash use." ***[Paragraph amended July 1, 2020]***

In a manner consistent with the non-GAAP guidance discussed above and the interpretive release, the SEC would generally expect registrants to disclose the following for all metrics and KPIs used:

- A clear definition of the metric and how it is calculated.
- A statement indicating the reasons why the metric provides useful information to investors.
- A statement indicating how management uses the metric in managing or monitoring the performance of the business.

- A description of any key estimates, assumptions, and limitations (e.g., whether the metric is a "hard" amount or an estimate).
- Presentation of the metric within a balanced discussion.

If metrics change or evolve as a result of the impact of COVID-19 or for any reason, registrants should ensure that there is clear and transparent disclosure of the change and that definitions of the affected metrics are updated accordingly. Further, to provide the appropriate context for changes to metrics, a registrant may need to recast prior periods to conform to the current presentation if the changes are significant.

Broad Financial Reporting and Accounting Considerations

Requirement to Develop Estimates, and Consistency of Assumptions and Estimates

As a result of the uncertainty associated with the unprecedented nature of the COVID-19 pandemic, entities have faced challenges related to selecting appropriate assumptions and developing reliable estimates. Nevertheless, they will still be required by U.S. GAAP to develop estimates that underly various accounting conclusions. To develop estimates, entities will need to consider all available information.

Further, entities may be required to use assumptions or estimates for more than one purpose (e.g., forecasted revenues or cash flows may be an assumption used in multiple impairment tests, in assessments of the realizability of deferred tax assets, and in an entity's ability to continue as a going concern). When a single assumption is used in multiple analyses, entities should verify that the same assumption is being used in each analysis unless the guidance in U.S. GAAP permits otherwise. For example, under the current expected credit loss (CECL) model, an entity is required to prepare its own reasonable and supportable forecasts, which is not necessarily consistent with a market-based fair value notion. Such consistency is particularly important for entities with multinational operations or with decentralized accounting and financial reporting functions.

In addition, entities should consider external events and circumstances when assessing whether (1) the changes made in assumptions and estimates from the previous period were appropriate or (2) it was appropriate in the current period not to have updated or changed the assumptions used in the previous period.

Disclosure Considerations

[Added September 18, 2020]

When developing estimates, entities need to consider whether they have met all applicable disclosure requirements. ASC 275-10-50-6[4] requires entities to disclose "discussion of estimates when, based on known information available before the financial statements are issued or are available to be issued , . . . it is reasonably possible that the estimate will change in the near term and the effect of the change will be material."

Entities preparing MD&A for inclusion in a filing with the SEC should consider the discussion of "early-warning" disclosures in the SEC Reporting and Disclosure Considerations — MD&A section above.

[4] For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*.")

Impairment of Nonfinancial Assets (Including Goodwill)

As a result of the changes in the current economic environment related to the COVID-19 pandemic, entities should consider whether they are experiencing any conditions (e.g., decreased revenues, order cancellations, supply chain disruptions, store closures, or declines in share price) that indicate that their assets should be tested for impairment. Even assets that have an annual impairment testing requirement, such as goodwill or indefinite-lived intangible assets, should be tested for impairment when a triggering event occurs. For example, the recent decline in global equity markets could lead an entity to conclude that it is required to test goodwill for impairment (because a decline in market capitalization could signal a change in facts and circumstances "that would more likely than not reduce the fair value of a reporting unit below its carrying amount," in accordance with ASC 350-20-35-30). The guidance for testing assets for impairment varies depending on the asset being tested. Some nonfinancial assets are tested for impairment individually, while others are tested as part of a larger unit of account. Further, some nonfinancial assets are tested by using a recoverability test, while others are tested by using a fair value or net realizable value (NRV) test. The guidance for testing nonfinancial assets for impairment is summarized in the following sections.

In addition, it is important to consider the order in which assets are tested so that the entity can ensure that any required adjustments are made before including those assets in the testing of larger units of account. Assets that are not held for sale should be tested for impairment in the following order: (1) assets outside of the scope of ASC 360-10 (other than goodwill) such as inventory, capitalized costs to obtain or fulfill a revenue contract, and indefinite-lived intangible assets, (2) long-lived assets in accordance with ASC 360-10, and (3) goodwill in accordance with ASC 350-20.

Inventory

The COVID-19 pandemic may affect the recoverability of inventory balances. Some entities with inventories that are seasonal or are subject to expiration may have to assess whether a larger reserve for obsolescence or slow-moving stock (e.g., markdowns) may be necessary at an interim or annual period as a result of a slower sales pace. Other entities may have to assess whether a decline in their future estimated selling price has arisen, which may require a write-down in the cost of inventory in an interim or annual period. In addition, manufacturing entities may have to reassess their practices for fixed overhead cost absorption if production volumes become abnormally low during the year as a result of plant closings or lower demand for their products.

ASC 330 requires that most inventory be measured at the lower of its cost or (1) market value (for inventory measured by using last in, first out [LIFO] or the retail inventory method) or (2) NRV (for all other inventory). In a volatile economic environment, it may be particularly important for entities to determine whether the utility of their inventory on hand has been impaired. Entities should apply the guidance in ASC 330-10-35-1A through 35-11, which addresses adjustments of inventory balances to the lower of cost or market or NRV as appropriate. Interim inventory impairment losses should generally be reflected in the interim period in which they occur, with subsequent recoveries recognized as gains in future interim periods of the same annual period.

In addition, entities with noncancelable, unhedged firm purchase commitments for inventory should recognize expected net losses on the basis of the lower of cost or market or NRV, as appropriate, in a manner consistent with the method for inventory on hand, to the extent that they are unable to recover such cost through reasonably assured selling prices or firmly committed sales contracts. ***[Paragraph added April 24, 2020]***

ASC 330 states that variable production overhead costs should be "allocated to each unit of production on the basis of the **actual use** of the production facilities" (emphasis added). It also calls for the allocation of fixed overhead costs to each manufactured item on the basis of an expectation that production facilities are running at **normal production** capacity, which refers to a "range of production levels [that are] expected to be achieved over a number of periods or seasons under normal circumstances" (e.g., annual production). The COVID-19 pandemic may affect manufacturing entities in a number of ways (e.g., shortages of labor and materials or unplanned factory downtime) that, if sustained, may result in an abnormal reduction of an entity's production levels. In those circumstances, an entity should not increase the amount of fixed overhead costs allocated to each inventory item. Rather, the unallocated fixed overhead costs are recognized in profit or loss in the period in which they are incurred.

Disclosure Considerations

[Added September 18, 2020]

ASC 330-10-50 provides disclosure guidance related to losses from applications of lower of cost or market and losses on firm purchase commitments.

Costs to Obtain or Fulfill a Revenue Contract and Up-Front Payments to Customers

An entity may have capitalized costs to obtain or fulfill a contract as an asset in accordance with ASC 340-40-25-1 or ASC 340-40-25-5, respectively. ASC 340-40-35-1 through 35-6 provide guidance on determining the appropriate amortization period and on recognizing any impairment loss on such an asset. An entity may need to update its amortization approach to reflect any significant changes in the expected timing of the transfer of the related goods or services. In addition, an entity must recognize an impairment charge if the carrying amount of the asset exceeds (1) the sum of the amount of consideration expected to be received and the amount of consideration already received but not yet recognized as revenue less (2) the costs that are directly related to providing the remaining promised goods or services under the contract that have not been recognized as expenses. The consideration determined in (1) above should be adjusted to reflect variable consideration on an unconstrained basis and to account for the customer's credit risk. The amounts determined under both (1) and (2) should include the effects of expected contract renewals from the same customer. An entity may also need to consider whether contract modifications or changes in expectations regarding customer renewals affect the amortization or recoverability of these revenue-related costs. ***[Paragraph amended April 24, 2020]***

An entity may also have capitalized up-front payments to customers that are reflected as a reduction in the transaction price. We believe that the entity should perform similar analyses for any asset recognized for such up-front payments.

Further, an entity should evaluate contract assets for impairment by using the same model as customer receivables. See the Financial Instruments and Contract Assets discussion for more information.

Disclosure Considerations

[Added September 18, 2020]

A public entity is required to disclose any impairment losses recognized for costs incurred to obtain or fulfill a contract.

Indefinite-Lived Intangible Assets Other Than Goodwill

As stated in ASC 350-30-35-4, an indefinite-lived intangible asset is one for which "there is no foreseeable limit on the period of time over which it is expected to contribute to the cash flows of the reporting entity." Certain brands, trademarks, or licenses (such as FCC licenses) are common examples.

Indefinite-lived intangible assets are tested annually for impairment and more frequently if an event or a change in circumstances indicates that it is more likely than not that the intangible asset is impaired in accordance with ASC 350-30. ASC 350-30-35-18B provides examples of these events or changes in circumstances, which include, but are not limited to, financial performance, legal or political factors, entity-specific events, and industry or market considerations. On the basis of this assessment, if an entity determines that it is more likely than not that the carrying value of the intangible asset exceeds its fair value, the entity performs a valuation to determine the fair value of the asset and recognizes an impairment loss equal to the excess of the carrying amount of the intangible asset over its fair value.

A valuation technique that is often applied to the measurement of a brand or trademark is the relief from royalty method. The relief from royalty method, which focuses primarily on expected revenues and royalty rates, requires the entity to make fewer assumptions than other income methods. However, an entity may find it challenging to project revenues because of the pandemic's unique impact not only on consumer buying decisions but also on the entity's ability to continue to (1) produce products in the event of supply chain disruptions or (2) deliver services in the event of shelter in place or work at home requirements, for example. Entities are expected to use their best estimate of all required business and valuation assumptions for this or other income methods used to measure the fair value of an indefinite-lived intangible asset.

In addition to evaluating the need for an interim impairment test, an entity should also consider whether there are any indicators that an intangible asset classified as indefinite-lived has become finite-lived, which might occur if an entity changes its expected use of the asset in response to the effects of the COVID-19 pandemic.

Disclosure Considerations

[Added September 18, 2020]

ASC 350-30-50-3 provides specific disclosure requirements for each impairment loss recognized related to an intangible asset.

Long-Lived Assets

An entity should consider whether it is experiencing (1) a decline in revenues, (2) an increase in costs (i.e., a decline in net cash flows), or (3) both as a result of the COVID-19 pandemic. Such changes may indicate that the entity should test its long-lived assets for recoverability. Although we expect each entity to be affected differently both in terms of the effects of the COVID-19 pandemic on its cash flows and on the susceptibility of its long-lived assets to impairment, an entity should document its considerations regarding the recoverability of its long-lived assets.

Entities are required by ASC 360-10-35-21 to test a long-lived asset (asset group) that is classified as held and used for recoverability "whenever events or changes in circumstances indicate that its carrying amount may not be recoverable" (e.g., a significant adverse change in the business climate that could affect the value of a long-lived asset [asset group]). Events or changes in circumstances that prompt a recoverability test are commonly referred to as "triggering events." In light of events such as store closures or idling of manufacturing facilities, or trends related to decreases in consumer spending, many entities are likely to experience one or more of the triggering events listed in ASC 360-10-35-21. For example, triggering

events that may be present as a result of the COVID-19 pandemic include, but are not limited to, a "significant decrease in the market price of a long-lived asset (asset group)," a "significant adverse change in the extent or manner in which a long-lived asset (asset group) is being used or in its physical condition," or a "current-period operating or cash flow loss combined with . . . a projection or forecast that demonstrates continuing losses associated with the use of a long-lived asset (asset group)."

ASC 360-10-35-23 states that "a long-lived asset or assets shall be grouped with other assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities." Such a combination is called an asset group.

An asset group may include not only long-lived assets that are within the scope of ASC 360-10 but also other assets such as receivables, inventory, indefinite-lived intangible assets, or goodwill. ASC 360-10-15-5 provides a list of assets that are not in the scope of ASC 360-10. Note that ASC 360-10 applies to long-lived assets that are not in the scope of other GAAP, such as property, plant, and equipment (PP&E); finite-lived intangible assets (customer relationships, technology, brands, and tradenames); and right-of-use assets.

To test a long-lived asset (asset group) for recoverability, an entity compares the carrying value of the asset (asset group) to the undiscounted net cash flows generated from the asset's (asset group's) use and eventual disposal. While the use of undiscounted cash flows generally indicates that a long-lived asset (asset group) is less prone to impairment, reductions in the estimates of undiscounted cash flows based on the expected duration and magnitude of the COVID-19 pandemic may indicate that the long-lived asset (asset group) is not recoverable.

If an entity estimates future cash flows to test the recoverability of a long-lived asset (asset group), such an estimate should include only the future cash flows (cash inflows minus associated cash outflows) that are (1) directly associated with the asset (asset group) and (2) expected to arise as a direct result of the use and eventual disposition of the asset (asset group). To estimate future cash flows, the entity must consider both cash inflows and cash outflows. ASC 360 indicates that it may be useful for the entity to apply a probability-weighted approach when it is considering alternative courses of action to recover the carrying amount of a long-lived asset (asset group). Such an approach may also be beneficial when the entity is considering alternative courses of action to manage cash outflows in response to anticipated revenue declines as well as when evaluating the extent of government intervention and the potential effects of any such intervention on both cash inflows and cash outflows.

ASC 360-10-35-30 states that the "assumptions used in developing [cash flow estimates should] be reasonable in relation to the assumptions used in developing other information used by the entity for comparable periods, such as internal budgets and projections, accruals related to incentive compensation plans, or information communicated to others."

If the entity determines that the carrying amount of the long-lived asset (asset group) is not recoverable, the entity then performs the next step in the impairment test by recognizing an impairment loss for the amount by which the carrying amount of the long-lived asset (asset group) exceeds its fair value. It then allocates that amount to the long-lived assets that are in the scope of ASC 360-10 "on a pro rata basis using the relative carrying amounts of those assets, except that the loss allocated to an individual long-lived asset of the group shall not reduce the carrying amount of that asset below its fair value whenever that fair value is determinable without undue cost and effort."

If an entity determines that a long-lived asset (asset group) is recoverable, it does not recognize an impairment loss, even if the carrying value of that asset (asset group) exceeds its fair value. Regardless of whether an entity recognizes an impairment loss, it should still consider whether the existence of a trigger indicates that there has been a change in the useful life or salvage value of its long-lived assets. If so, it should revise its depreciation or amortization estimates accordingly.

Sometimes, an entity may conclude that the affected long-lived assets will be sold, abandoned, or otherwise disposed of. Under ASC 360, if the held-for-sale criteria in ASC 360-10-45-9 are met, the entity is required to measure the asset (asset group) "at the lower of its carrying amount or [its] fair value less cost to sell" in accordance with ASC 360-10-35-43. A long-lived asset that will be abandoned will continue to be classified as held and used until it is disposed of. Such an asset is disposed of when it ceases to be used. However, a "long-lived asset that [is] temporarily idled shall not be accounted for as if abandoned" in accordance with ASC 360-10-35-49. Further, when "a long-lived asset ceases to be used, the carrying amount of the asset should equal its salvage value, if any."

Disclosure Considerations

[Added September 18, 2020]

ASC 360-10-50 provides disclosure requirements for impairments of long-lived assets classified as held and used and for long-lived assets classified as held for sale or disposed of.

Leases (ASC 842) — Right-of-Use Assets

Impairments to right-of-use (ROU) assets could occur as a result of business closures, supply chain disruption, or other consequences of the pandemic that negatively affect the future cash flows expected to be derived from the use of the underlying PP&E.

ROU assets are subject to the impairment and disposal guidance in ASC 360; therefore, a lessee must test its ROU assets for impairment in a manner consistent with the treatment of other long-lived assets. In accordance with ASC 842-20-35-9, a "lessee shall determine whether a right-of-use asset is impaired and shall recognize any impairment loss in accordance with Section 360-10-35 on impairment or disposal of long-lived assets." Therefore, the impairment analysis of ROU assets would be included as part of the analysis discussed above for long-lived assets that are held and used.

In accordance with ASC 842-20-35-10, an impaired ROU asset should be subsequently measured at its carrying amount (after the impairment) less any accumulated amortization. Subsequent amortization of the ROU asset (for both operating and finance leases) would be on a straight-line basis unless another systematic basis is more representative of the pattern over which the lessee expects to consume the remaining economic benefits of the right to use the underlying asset.

In connection with its reevaluation of leases or lease portfolios on a go-forward basis, a company should consider whether a decision to no longer use a leased asset constitutes an abandonment of the asset from an accounting standpoint. The company's conclusion may represent a triggering event that prompts the company to perform a recoverability test. For a leased asset to be deemed abandoned, a company must not have the intent and ability to sublease the leased asset at any point during the remaining lease term. When determining whether it would have the intent and ability to sublease the asset, a company should consider the economic environment and the expected demand in the sublease market. Consequently, it may be required to use more judgment when assessing longer remaining lease terms. A company that has the intent and ability to sublease an asset at any point in the future would be precluded from considering an asset to be abandoned. ***[Paragraph added September 18, 2020]***

For more information, see Q&A 8-12, *Considerations Related to the Impairment of an ROU Asset*, in Deloitte's *A Roadmap to Applying the New Leasing Standard*.

Disclosure Considerations

[Added September 18, 2020]

Additional disclosures may be required about an ROU asset (or asset group) that is impaired or abandoned. Entities should assess whether they have met all applicable disclosure requirements, including those in ASC 360. Under ASC 360-10-50, entities would disclose a description of the impaired asset (or asset group), the facts and circumstances leading to the impairment, the method(s) for determining fair value, and the amount of impairment if not separately presented in the financial statements.

ASC 360-10-50 provides disclosure requirements related to long-lived asset disposals in the period in which an entity ceases to use the rights conveyed under the lease and deems the ROU to be abandoned. Such disclosures would include items such as the description of the facts and circumstances leading to the disposal, the disposal's expected manner and timing, and any gain or loss recognized.

Goodwill

As a result of the effects of the COVID-19 pandemic, we expect more entities to conclude that there is a requirement to test the goodwill of one or more reporting units for impairment between annual testing dates. For many entities, recoverability of goodwill balances has not been a heightened concern in recent years because of overall favorable economic conditions. Specifically, until recently, the market capitalization of many publicly reporting entities has been in excess of their carrying amounts as measured by net assets. Such excesses may no longer exist for some entities because of recent dramatic declines in equity markets.

Under ASC 350-20-35-28 through 35-30, an entity is required to test goodwill for impairment at the reporting-unit level at least annually or "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." ASC 350-20-35-3C provides examples of events and circumstances that may meet such a threshold and hence necessitate the testing of goodwill for impairment between annual tests. These include "a deterioration in general economic conditions," "a deterioration in the environment in which an entity operates," "a change in the market for an entity's products or services," "[o]verall financial performance such as negative or declining cash flows or a decline in actual or planned revenue or earnings compared with actual and projected results of relevant prior periods," and, "[i]f applicable, a sustained decrease in share price (consider in both absolute terms and relative to peers)."

A reporting unit with only a small cushion (excess of fair value over carrying amount) at the time of its most recent quantitative test is generally more susceptible to impairment, which may have been noted in prior disclosures related to goodwill of reporting units at higher risk for impairment.

An entity may choose to qualitatively evaluate relevant events or circumstances to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Alternatively, an entity may skip the qualitative assessment and proceed directly to step 1 of the goodwill impairment test. In step 1 of the test, the entity compares the reporting unit's carrying amount, including goodwill, with its fair value and recognizes an impairment loss for any excess.

In January 2017, the FASB issued ASU 2017-04,[5] which eliminated step 2 of the goodwill impairment test and the requirement to calculate the implied fair value of goodwill. While that

[5] FASB Accounting Standards Update No. 2017-04, *Simplifying the Test for Goodwill Impairment*.

ASU is not yet effective for all entities (e.g., private companies and not-for-profit entities), many entities have elected to early adopt its provisions. Note that because ASC 350-20-35-18 is superseded by ASU 2017-04, entities that have adopted the ASU will no longer be permitted to book a "best estimate" of the impairment when step 2 is not complete and subsequently recognize any adjustment in the following reporting period when step 2 is complete. If public entities need additional time to complete the goodwill impairment test, they should consider the deadline relief provided by the SEC (see the Deadline Relief discussion for further detail). ***[Paragraph amended April 24, 2020]***

When performing a quantitative test, an entity must develop certain business and valuation assumptions. If the entity is using an income approach when performing its fair value measurements, the entity must apply judgment when developing its prospective financial information because of the unique nature of the COVID-19 pandemic and the resulting impacts on government, business, and consumer decisions. The entity is expected to use its best estimates of those business and valuation assumptions. In addition, if the entity is using a market approach when performing its fair value measurements, the entity may encounter challenges in the current environment related to identifying the appropriate multiples and transactions to use. Consultation with valuation specialists may be warranted.

When performing a quantitative test for impairment, a publicly traded entity with multiple reporting units generally assesses the reasonableness of the resulting implied control premium as measured by the percent by which the aggregate sum of the fair values of its reporting units exceeds the entity's market capitalization. Such a comparison is not required by U.S. GAAP and may be more difficult to perform in the current environment because of market volatility. However, the comparison can continue to yield useful information about the reasonableness of the underlying reporting unit's fair value measurements.[6] In cases of market volatility, an entity may need to apply judgment in determining the market capitalization to use in the comparison.[7]

ASC 350 provides an accounting alternative for the subsequent measurement of goodwill for private companies and not-for-profit entities. While certain differences exist for entities adopting the accounting alternative, such entities are required to test goodwill for impairment when a triggering event occurs.

Disclosure Considerations

[Added September 18, 2020]

ASC 350-20-50-2 provides disclosure requirements for impairments of goodwill.

Financial Instruments and Contract Assets

Impairment and Valuation Considerations

As a result of the pandemic, entities may need to assess their investments and loans for impairment. Investments that may be affected include equity securities and private debt and, in certain instances, investments in sovereign debt. Moreover, the COVID-19 pandemic may cause additional volatility in the global markets, which has affected the fair values of investments (e.g., credit spreads may widen or the creditworthiness of counterparties may be affected).

[6] For more information on assessing the reasonableness of an implied control premium, see the AICPA's Accounting and Valuation Guide *Testing Goodwill for Impairment* (2013) and the Appraisal Foundation's *Valuations in Financial Reporting Valuation Advisory 3: The Measurement and Application of Market Participant Acquisition Premiums* (2017). ***[Footnote added April 24, 2020]***

[7] For more information, see the remarks by then SEC Professional Accounting Fellow Robert G. Fox III at the 2008 AICPA Conference on Current SEC and PCAOB Developments. ***[Footnote added April 24, 2020]***

The following guidance applies to investments in equity securities that are not accounted for at fair value with changes in fair value recognized in earnings:

- *Equity securities without readily determinable fair values* — ASC 321-10-35-3 and 35-4 address the subsequent measurement of equity securities without readily determinable fair values that are accounted for by using the measurement alternative described in ASC 321-10-35-2. ASC 321-10-35-3 states, in part, that "[a]n equity security . . . measured in accordance with paragraph 321-10-35-2 shall be written down to its fair value if a qualitative assessment indicates that the investment is impaired and the fair value of the investment is less than its carrying value."

  ASC 321-10-35-4 further states that for such an impaired equity security, "an entity shall include an impairment loss in net income equal to the difference between the fair value of the investment and its carrying amount." Because the fair value of such an investment is not readily determinable, the entity will need to estimate the fair value under ASC 820 to measure the amount of the impairment loss. Once an investment in an equity security that is measured under ASC 321-10-35-2 is impaired, the entity cannot recognize a recovery in the investment's fair value in the absence of an observable price change for an identical or a similar security, as discussed in ASC 321-10-35-2.

  ASC 321-10-35-3 requires entities to perform a qualitative assessment in each financial reporting period to evaluate whether equity securities accounted for under the measurement alternative in ASC 321-10-35-2 are impaired. That qualitative assessment is performed on the basis of the impairment indicators in ASC 321-10-35-3. Entities should note that ASC 321-10-35-3(c) applies particularly to the COVID-19 impacts; it states, in part, that one indicator of impairment is "[a] significant adverse change in the general market condition of either the geographical area or the industry in which the investee operates." This impairment indicator will often be met as a result of significant declines in equity prices globally that have occurred as a result of the COVID-19 pandemic.

  In the evaluation of an equity security for impairment, neither the significance of the impairment amount nor the impairment's duration is relevant. Although the fair value of nonmarketable equity securities may be difficult to measure because of the unobservability of inputs, entities that have investments whose fair values have been affected by the pandemic must make a reasonable estimate of fair value when recognizing impairment losses. Such impairment losses must be recognized for declines in fair value below the carrying amount even if the investor believes that such declines are temporary in nature. In addition to evaluating and recognizing an impairment, an entity would write down the carrying amount of an equity security that is accounted for by using the measurement alternative in ASC 321-10-35-2 if an observable price change in an identical or a similar security reflects a fair value that is below the investment's previously recorded carrying amount.

  To assess and measure impairment losses, entities that have a significant number of equity securities that are accounted for by using the measurement alternative described in ASC 321-10-35-2 will need to stratify (or group) investments into those that share similar attributes. Factors to consider include, but are not limited to:

  - *Any appreciation in fair value since the original acquisition of the investment that has not been recognized as a remeasurement event (i.e., the investment must be remeasured at fair value if the entity observes a transaction in the same or similar security)* — For example, some investments may represent "seed money" investments that were made when the fair value of the investee's equity was relatively low. In these situations, there may have been a significant increase in fair value during the recent bull market. Thus, investors may be able to determine, without having to apply significant judgment, that although the fair value of such investments

has declined recently as a result of the impact that COVID-19 has had on stock markets, there is still a sufficient "cushion" between the fair value and carrying amount so that an impairment loss has not been incurred.

- *The industry in which the investee entity operates* — Some industries have performed relatively well since the onset of the pandemic. For example, certain companies that provide teleconferencing services, food and other delivery services, cleaning and other health supplies, pharmaceutical solutions, and other technology solutions have outperformed other stocks generally. An investee that operates in a sector that has performed relatively well during the pandemic may be less susceptible to material impairment losses; however, in such a scenario, specific consideration is required and the impairment determination may depend on the fundamentals applicable to the investee. Other companies, such as airlines and other travel-related entities, have been severely affected and thus have a higher risk of material impairment losses.
- *The geographic location of the investee entity* — Although COVID-19 has generally resulted in declines in stock prices globally, the significance of those declines has varied among different regions. Thus, if an entity has investments in nonmarketable equity securities in geographic locations that have not experienced price declines that are as significant as those in other areas, those investments may be less susceptible to impairment losses.
- *The size of the investee entity* — Since the start of the pandemic, the performance of small-cap equities has generally been poorer in the United States than that of other equities. Thus, investments in smaller companies may be considered to have been more significantly affected by COVID-19.
- *The quantitative significance of the investee entity* — Entities that have numerous investments may "scope" the evaluation in a manner that focuses on those investments that are of a magnitude such that impairment losses could be material. For example, an entity may determine that there is a population of investee entities whose carrying amount, in the aggregate, is inconsequential. Since the maximum potential impairment loss cannot exceed the carrying amount, the entity may decide to focus only on investments that individually or in the aggregate could have material impairment losses.
- *Other factors specific to the investee entity* — An investor may be aware of specific information that positively or negatively affects an individual investee. For example, an investee with nonpublicly traded equity securities may have issued announcements to the public that reflect either the positive or negative impacts of the pandemic. In addition, some investees may have other publicly traded securities such as bonds or convertible instruments. Entities may find observable pricing information pertaining to such other investments to be useful in evaluating impairment losses.
- *Liquidity risk premiums* — Entities should keep in mind that the fair value of an illiquid equity investment could be more significantly affected by the COVID-19 outbreak than a readily tradable equity security. Thus, in determining fair value, entities should take into account the need to reconsider any nonmarketability discount applied in the estimation of fair value.

Disclosure Considerations

[Added September 18, 2020]

ASC 321-10-50-3 contains specific disclosure requirements that apply in any financial reporting period for which an entity adjusts the carrying amount of an equity security that it accounts for by using the measurement alternative in

ASC 321-10-35-2. (Note that the disclosure requirements in ASC 820 related to nonrecurring fair value measurements also apply.) In addition, entities should consider disclosing the significant judgments they applied in estimating impairment losses on equity investments that are accounted for by using the measurement alternative in ASC 321-10-35-2.

- *Investments in equity method investments and joint ventures* — Entities with equity method investments or joint ventures that are adversely affected by the economic uncertainty in the affected regions may need to evaluate whether decreases in an investment's value are other than temporary. For these investments, ASC 323-10-35-31 requires the recognition of a loss that is other than temporary even if such a decrease in value is greater than what would otherwise be recognized if the equity method were applied. As indicated in ASC 323-10-35-32, "[e]vidence of a loss in value might include [a lack of] 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." Further, ASC 323-10-35-32 states that a "current fair value of an investment that is less than its carrying amount may indicate a loss in value of the investment."

  Note that in the determination of whether there is an impairment loss that should be recognized, many of the considerations relevant to nonmarketable equity securities that are accounted for by using the measurement alternative in ASC 321-10-35-2 may be relevant. However, unlike the impairment guidance applicable to investments accounted for under ASC 321-10-35-2, an impairment loss on an equity method investee is recognized only if it is other than temporary in nature. Therefore, equity method investors must apply judgments regarding the severity and duration of any decline in fair value before recognizing impairment losses on equity method investees. In many cases, those judgments are influenced by the reason for the investment (e.g., strategic vs. financial). Entities should consider disclosing significant judgments made in the evaluation of other-than-temporary impairment of equity method investees.

  If an entity (1) accounts for its share of equity method investment earnings and losses by using a time lag on the basis of the guidance in ASC 323-10-35-6 and (2) determines that it should recognize an impairment loss for its equity method investment, the entity should measure and recognize the fair value of the equity method investment as of the date of the other-than-temporary impairment and not use a lag (i.e., to recognize and measure an impairment for its equity method investment, the entity should not use a lag in a manner consistent with how it records its share of earnings and losses). ***[Paragraph added April 13, 2020]***

Disclosure Considerations

[Added September 18, 2020]

If an equity method investment is other than temporarily impaired (resulting in a write-down to fair value), the entity must provide all relevant ASC 820 fair value disclosures pertaining to items measured at fair value on a nonrecurring basis. In addition, while the ASC 820 and ASC 825 fair value disclosures are not required for equity method investments that have not been written down to fair value as a result of an other-than-temporary impairment, an entity can voluntarily provide these disclosures. If an entity decides to disclose such information, it should adopt a rational and consistent policy for doing so (e.g., for all reporting periods and investment types). See Section 2.3.2.2.4 of Deloitte's *A Roadmap to Fair Value Measurements and Disclosures (Including the Fair Value Option)* for further discussion of the applicability of the disclosure requirements in ASC 820 and ASC 825 to equity method investments.

The impairment model applied under U.S. GAAP to financial assets other than equity investments depends on the investment's classification and whether the entity has adopted ASC 326. The following guidance applies to entities that have not yet adopted ASC 326:

- *Available-for-sale (AFS) and held-to-maturity (HTM) debt securities* — Under ASC 320-10-35, the impairment of a debt security is considered other than temporary if the entity intends to sell the security as of the measurement date or has determined that it is more likely than not that it will be required to sell the security before the recovery of its amortized cost basis. Further, an other-than-temporary impairment is considered to have occurred if (1) the entity does not intend to sell the security, (2) it is not more likely than not that the entity will be required to sell the security before recovering its amortized cost basis, and (3) the entity does not expect to recover the entire amortized cost basis of the debt security (i.e., a credit loss is considered to have occurred).

  In determining the amount of impairment loss to recognize, entities should refer to the guidance in ASC 320-10-35-34B through 35-34D and ASC 320-10-35-33D. As a result of the COVID-19 pandemic, an entity may need to recognize an impairment loss if it (1) has determined that sales of AFS debt securities are inevitable because it must replenish cash and other capital resources that have been expended and (2) has not generated sufficient replacement cash flows (e.g., an entity could determine that it is more likely than not that it would be required to sell AFS debt securities). In addition, entities should be mindful that, in determining credit losses, credit rating agencies are often slow to reflect credit rating downgrades (e.g., a large number of investment-grade debt securities may already reflect negative attributes that suggest they are no longer of investment grade). Entities therefore should consider credit losses that exist as of the balance sheet date that are not yet reflected in credit ratings. An entity may evaluate bond credit spreads and other fixed-income market indicators in making such assessments.

Disclosure Considerations

[Added September 18, 2020]

ASC 320-10-50 contains numerous disclosure requirements related to other-than-temporary impairments of AFS and HTM debt securities. For example, specific disclosure requirements apply (1) when an other-than-temporary impairment has been recognized and for securities in an unrealized loss position for which an impairment has not been recognized. In complying with the requirements in ASC 320-10-50-6, an entity should consider whether the impact of the COVID-19 pandemic represents "other information that the investor considers relevant" in the disclosure of the "evidence considered by the investor in reaching its conclusion that the investment is not other-than-temporarily impaired" (see ASC 320-10-50-6(b)(5)(x)).

- *Loans* — Creditors that lend to entities that may be adversely affected by economic instability resulting from the pandemic will need to assess whether certain events (such as downgrades in borrower credit ratings or declines in cash flows and liquidity) indicate that an impairment evaluation is required. The economic uncertainty could also result in loan modifications that must be accounted for as a troubled debt restructuring (TDR) in accordance with ASC 310-40. For entities that have not yet adopted ASC 326, a modification is not accounted for as a TDR before the date the modification has occurred (i.e., a legally binding agreement is in place). Nevertheless, even before the occurrence of such a modification, entities should consider the impact on incurred losses that results from changes in credit risk related to borrowers for which modifications may occur.

Section 4013 of the CARES Act gives financial institutions temporary relief from the TDR accounting and disclosure requirements in ASC 310-40 for certain loan modifications that are made in response to the COVID-19 pandemic. In addition, on April 7, 2020, a group of banking agencies issued a revised interagency statement that offers some practical expedients for evaluating whether loan modifications that occur in response to the COVID-19 pandemic are TDRs. For more information on the evaluation of loan modifications under Section 4013 of the CARES Act and the revised interagency statement, see Deloitte's *Heads Up*, "Frequently Asked Questions About Troubled Debt Restructurings Under the CARES Act and Interagency Statement." ***[Paragraph added April 24, 2020]***

Disclosure Considerations

[Added September 18, 2020]

Entities that elect to apply either Section 4013 of the CARES Act or the revised interagency statement should disclose the application of such guidance as an accounting policy. In a review of the Forms 10-Q filed for the second quarter of 2020 by 10 of the largest U.S. banks, we noted the following:

- All of the banks disclosed, in the accounting policy section of the footnotes, their application of the CARES Act and interagency statement to COVID-19-related modifications. (Note that all entities with material amounts of loan modifications that are not accounted for as TDRs as a result of Section 4013 of the CARES Act or the interagency statement would be expected to disclose such information in accordance with the requirements in ASC 235 related to disclosing accounting policies.)
- All of the banks disclosed how COVID-19-related modifications that were not accounted for as TDRs affected their reporting of the delinquency (past-due) status of loans. Eight of these ten banks included this disclosure in the footnotes to the financial statements, whereas two included it only in MD&A. (Note that all entities with material amounts of loan modifications that are not accounted for as TDRs as a result of Section 4013 of the CARES Act or the interagency guidance would be expected to disclose such information in accordance with the requirements in ASC 310 and ASC 326 related to disclosing nonaccrual and past-due loans.)
- All of the banks disclosed the principal amount of loans subject to COVID-19 modifications that were not accounted for as TDRs and generally provided such information by loan type. Three of these ten banks included this disclosure in the footnotes to the financial statements, whereas seven included it only in MD&A. (Note that although entities are not specifically required to disclose this information, we understand that the SEC's Division of Corporation Finance believes that it would be relevant to users of the financial statements.)

- *Receivables* — Receivables from entities may need to be evaluated for collectibility in accordance with ASC 310. Entities should pay particular attention to the assessment of recoverability when receivables are overdue, even if the entities have the right to charge interest for late payment. Entities should also evaluate receivables from customers in geographic regions that are most affected by COVID-19 even if those receivables are not yet past due. Entities may incur additional write-offs of receivables deemed uncollectible or may be required to establish additional reserves on receivables due from entities that are affected (or expected to be affected) by the impacts of COVID-19.

Disclosure Considerations

[Added September 18, 2020]

Entities should consider how the COVID-19 pandemic may affect their disclosure requirements under ASC 310-10-50. For example, election of the TDR practical expedient in Section 4013 of the CARES Act or the revised interagency statement would affect an entity's accounting policy disclosures and how it determines the past-due status of affected loans (see discussion above of disclosure observations from practice). Entities should also be mindful that ASC 310-10-50-11B(a)(1) requires disclosure of "the factors that influenced management's judgment" related to the estimation of credit losses and, as stated in ASC 310-10-50-11B(a)(1)(ii), that "[e]xisting economic conditions" must be considered. In addition, the credit-quality disclosures required by ASC 310-10-50 must include discussion of the qualitative risks arising from an entity's financing receivables and how management monitors those risks.

- *Contract assets* — As is the case with receivables, entities that have contract assets will need to evaluate recorded amounts for impairment in accordance with ASC 310 by assessing the customer's ability to pay amounts when due. The customer's ability to pay may be adversely affected by the economic instability resulting from the impacts of COVID-19.
- *Net investments in sales-type or direct financing leases* — Lessors that have entered into sales-type or direct financing leases should evaluate their net investments in leases in accordance with ASC 842-30-35-3 (which requires any loss allowance to be recorded as indicated in ASC 310). This evaluation should take into consideration changes in both (1) the credit risk of the lessee and (2) the cash flows expected to be derived from the underlying leased property at the end of the lease. Such changes include, for example, potential cash flows from the sale of the property at the end of the lease or from renewals with the same lessee. Therefore, a deterioration in market conditions may lead to a decline in the leased asset's value, resulting in an impairment of the net investment in the lease even if the lessee's credit quality has not deteriorated.

Entities that have adopted ASC 326 must apply the CECL impairment model to recognize credit losses on financial assets with contractual cash flows that are carried at amortized cost (including HTM debt securities), net investments in leases (except for operating lease receivables), reinsurance receivables, and off-balance-sheet credit exposures. Since the CECL model is based on expected losses rather than incurred losses, an allowance for credit losses under ASC 326-20 reflects (1) a risk of loss (even if remote) and (2) losses that are expected over the contractual life of the asset.

Connecting the Dots

As the FASB clarified in ASU 2018-19,[8] operating lease receivables are not within the scope of CECL, although net investments in sales-type and direct financing leases are within the scope of ASC 326. An entity would need to apply other guidance — namely ASC 842 — to evaluate the impairment implications associated with operating lease receivables. For more information, see Deloitte's *Financial Reporting Alert*, "Assessing the Collectibility of Operating Lease Receivables."

The allowance takes into account historical loss experience, current conditions, and reasonable and supportable forecasts. Because the CECL model does not specify a threshold for recognizing an impairment allowance, entities should assess the current and expected future adverse effects of a pandemic and incorporate such effects into their estimate of expected credit losses on each reporting date. They should also "evaluate whether a financial asset in a pool continues to exhibit similar risk characteristics with other financial assets in the

[8] FASB Accounting Standards Update No. 2018-19, *Codification Improvements to Topic 326,* Financial Instruments — Credit Losses.

pool" in accordance with ASC 326-20-35-2 or whether the risk characteristics of the financial asset have been affected by COVID-19 so that the asset should be removed from its current pool and either (1) moved into a different pool or (2) evaluated individually if it no longer shares risk characteristics with any other financial assets.

The allowance for credit losses under the CECL model is affected by both executed TDRs and reasonably expected TDRs. Section 4013 of the CARES Act gives financial institutions temporary relief from the TDR accounting and disclosure requirements in ASC 310-40 for certain loan modifications that are made in response to the COVID-19 pandemic. In addition, on April 7, 2020, a group of banking agencies issued a revised interagency statement that offers some practical expedients for evaluating whether loan modifications that occur in response to the COVID-19 pandemic are TDRs. For more information on the evaluation of loan modifications under Section 4013 of the CARES Act and the revised interagency statement, see Deloitte's *Heads Up*, "Frequently Asked Questions About Troubled Debt Restructurings Under the CARES Act and Interagency Statement." ***[Paragraph added April 24, 2020]***

In some cases, entities that have adopted ASC 326 may decide to shorten the reasonable and supportable forecast period for certain portfolios because of the forecast uncertainty that results from the pandemic. In these situations, entities should also reevaluate both the reversion period and the historical loss data used for reversion purposes. For example, when an entity shortens the reasonable and supportable forecast period, it would most likely also increase the reversion period. Furthermore, depending on the remaining contractual maturity of the portfolio, it may further determine that the historical loss information used in the post-reversion period should reflect losses incurred during a volatile economic environment (as opposed to long-term loss data over an entire economic cycle).

Connecting the Dots

For entities adopting ASC 326 as of January 1, 2020, we generally do not believe that the recent events related to COVID-19 (e.g., failure of containment, subsequent spread, declaration of a global pandemic, and severity of the impact on global economics) were known or knowable as of the transition date. Therefore, it would not be appropriate to use hindsight in determining the ASC 326 transition adjustment. Developments after January 1, 2020, would be considered in the first quarter of adoption, with any change in estimate affecting the income statement.

Disclosure Considerations

[Added September 18, 2020]

ASC 326-20-50-11 requires entities to disclose the method they used to estimate credit losses, including a discussion of the factors that influenced management's current estimate of expected credit losses and how changes in those factors affected the allowance for credit losses. In circumstances in which an entity shortens its reasonable and supportable forecast period or changes its reversion approach, it would need to disclose these facts if such changes materially affect the allowance for credit losses. Entities should also consider disclosing the quantitative effect of the COVID-19 pandemic on the allowance for credit losses (and credit loss expense during the period). Further, they should consider disclosing how modifications that were not accounted for as TDRs affected credit loss estimates, including the allowance for credit losses on accrued interest receivable.

Under ASC 326-30, an entity also uses an allowance approach when recognizing expected credit losses on an AFS debt security. ASC 326-30-35-3 requires an entity to recognize as an allowance an AFS debt security's expected credit losses, limited by the difference between the security's fair value and its amortized cost basis. Any changes in the allowance for expected credit losses on an AFS debt security would be recognized as an adjustment to the entity's credit loss expense. ASC 326-30-55-1 lists numerous factors that an entity should consider

in determining whether a credit loss exists, including adverse financial conditions. While an allowance model is applied for entities that have adopted ASC 326-30, the factors and approach used to measure credit losses are generally unchanged (see the discussion above of AFS and HTM debt securities).

Disclosure Considerations

[Added September 18, 2020]

Although ASU 2016-13 made targeted changes to the impairment model for AFS debt securities (e.g., it introduced an allowance model), the disclosure requirements are largely unchanged. However, entities that adopted ASU 2016-13 must apply the disclosure requirements in ASC 326-20 for HTM debt securities. Entities with AFS debt securities should see the disclosure considerations discussed above, which apply before and after the adoption of ASU 2016-13.

The sections below discuss fair value measurement and disclosure considerations that may be relevant to impairment assessments.

Recognition of Interest Income

[Section added April 24, 2020]

ASC 310-20-35-18(a) addresses the application of the interest method to loan receivables for which the stated interest rate is not constant throughout the loan's term and states:

> If the loan's stated interest rate increases during the term of the loan (so that interest accrued under the interest method in early periods would exceed interest at the stated rate), interest income shall not be recognized to the extent that the net investment in the loan would increase to an amount greater than the amount at which the borrower could settle the obligation. Prepayment penalties shall be considered in determining the amount at which the borrower could settle the obligation only to the extent that such penalties are imposed throughout the loan term. (See Section 310-20-55.) Accordingly, a limit is imposed on the amount of periodic amortization that can be recognized. However, that limitation does not apply to the capitalization of costs incurred (such as direct loan origination costs and purchase premiums) that cause the investment in the loan to be in excess of the amount at which the borrower could settle the obligation. The capitalization of costs incurred is different from increasing the net investment in a loan through accrual of interest income that is only contingently receivable.

In response to economic difficulties that arise from the COVID-19 pandemic, many lenders are modifying the payment structure of loans to allow for a temporary deferral of contractual payments due. If a lender defers payments of principal and interest on a loan receivable, adds those deferred payments to the end of the loan's term, and does not increase the amounts owed for interest that would have accrued during the deferral period, the borrower may be able to prepay its loan at an amount equal to the outstanding amount due as of the beginning of the deferral period. If an entity applies the limitation in ASC 310-20-35-18(a), no interest would be accrued by the lender during the deferral period. However, if the entity does not apply ASC 310-20-35-18(a), the lender could continue to accrue interest during the deferral period even though the carrying amount of the loan could be increased to an amount that exceeds the amount for which the borrower could prepay its loan without a prepayment penalty. (However, in recognizing interest income, the lender would need to recalculate the loan's effective yield by taking into account the payment deferral.)

Because some practitioners viewed the scope of ASC 310-20-35-18(a) to be ambiguous, an industry group sent a technical inquiry to the FASB. In its response, the FASB determined that two interpretations of the language in ASC 310-20-35-18(a) were acceptable for loans that are granted a payment deferral for which the payment deferral resulted in neither a TDR nor a new loan for accounting purposes. (Note that this issue does not apply to loans modified in a TDR because they are generally placed on nonaccrual.) Under one interpretation, the guidance in ASC 310-20-35-18(a) applies and therefore no interest is accrued during the

deferral period (however, entities would continue to amortize any discounts or premiums). Under the other interpretation, entities would continue to accrue interest and amortize discounts and premiums during the deferral period. Both alternatives will generally require lenders to recalculate the loan's effective yield. Under the first alternative, that recalculation is necessary to apply the interest method once the deferral period ends. Under the second alternative, that recalculation is necessary to apply the interest method during the deferral period and in periods thereafter. Such calculations may be complex for loans with variable interest rates. Entities that apply the second alternative and accrue interest income during the deferral period should evaluate the need to provide an allowance for credit losses on any such accrued interest.

Although the FASB staff answered the technical inquiry in the context of a specific fact pattern, we understand from informal discussions with the FASB staff that its answer was intended to result in an accounting model to be applied broadly to all loans that are modified to incorporate payment deferrals. (Note that this interpretation does not apply to loans that are originated with an introductory payment deferral.) The election of either of the two interpretations constitutes an accounting policy decision that must be applied consistently to all loans that are modified to incorporate payment deferrals. Some entities may have already established their accounting policy election (i.e., entities that had a preexisting accounting policy that addressed similar situations encountered in prior reporting periods). Entities that have not yet made such an accounting policy election will need to make their election in the first financial statements issued after the FASB announcement.

The AICPA has issued a technical question and answer that provides additional considerations related to loan restructurings that result in periods of reduced payments. ***[Paragraph added July 8, 2020]***

Disclosure Considerations

[Added September 18, 2020]

In accordance with ASC 235, entities should disclose their elected accounting policy and consider providing additional information about how the policy elected affects the amounts of interest accrued.

Transfers/Sales of HTM Investments

[Section amended April 13, 2020]

An entity holding HTM investments issued by entities that may be adversely affected by the economic uncertainty associated with COVID-19 may choose to transfer such investments out of the HTM classification or sell them. A decision to transfer or sell an HTM investment could call into question or "taint" the entity's intent to hold other investments in its HTM portfolios in the future unless the sale or transfer qualifies for one of the limited exceptions in ASC 320-10-25. Therefore, an entity will need to carefully evaluate whether its sales or transfers of HTM investments meet one of those exceptions.

For example, ASC 320-10-25-6(a) states that if there is evidence of a significant deterioration in the issuer's creditworthiness, an investor's decision to change its intent to hold that security would not be inconsistent with its original classification decision (i.e., it would not taint the remaining HTM portfolio). In addition, ASC 320-10-25-9 specifies that events that are isolated, nonrecurring, and unusual for the entity and that could not be reasonably anticipated may cause the entity to sell or transfer an HTM debt security without necessarily calling into question the entity's intent to hold other HTM debt securities to maturity. An entity's belief that it meets the conditions in ASC 320-10-35-9 because of the impacts of COVID-19, along with its decision to transfer or sell HTM securities on more than one occasion, would be inconsistent with the notion that the events are isolated and nonrecurring. For example, an entity cannot

transfer some securities out of HTM in March and then also decide to transfer more securities out of HTM in June without calling into question its intent to hold its remaining HTM portfolio.

Disclosure Considerations

[Added September 18, 2020]

ASC 320-10-50-10 requires entities to disclose all of the following for any transfers or sales of HTM debt securities during a financial reporting period:

a. The net carrying amount of the sold or transferred security

b. The net gain or loss in accumulated other comprehensive income for any derivative that hedged the forecasted acquisition of the held-to-maturity security

c. The related realized or unrealized gain or loss

d. The circumstances leading to the decision to sell or transfer the security.

Transfers of Investments Into or Out of Trading Classification

[Section added April 13, 2020]

As a result of the economic uncertainty associated with COVID-19, an entity holding debt securities classified as trading may change the way it manages those securities. For example, a financial institution may decide that it needs to use certain debt securities in its trading portfolio as collateral for borrowing under various programs, including federal lending programs. ASC 320-10-35-12 states that "given the nature of a trading security, transfers into or from the trading category . . . should be rare." In a manner similar to transfers or sales out of the HTM portfolio (discussed above), we believe that the current economic environment may result in a rare circumstance in which an entity may reclassify securities out of the trading portfolio. However, we believe that transfers of securities out of the trading portfolio on more than one occasion for the same reason (e.g., because of the impacts of COVID-19) would not be consistent with the notion that such transfers are "rare."

Further, we believe that transfers of securities into the trading category would not be allowed. A transfer into that category would result in immediate recognition of any previously unrealized gain or loss at the time of transfer, and securities that an entity intends to sell in the short term can be classified as AFS.

Disclosure Considerations

[Added September 18, 2020]

Although ASC 320-10-50 does not require an entity to disclose transfers of debt securities from the trading category to AFS, entities should nevertheless consider whether providing relevant information regarding such transfers would be useful to stakeholders.

Classification of Current and Noncurrent Financial Liabilities

Liabilities are generally classified as current in an entity's balance sheet if they are reasonably expected to be settled by the entity within 12 months of the end of the reporting period (see ASC 210-10-45-5 through 45-12 for additional discussion). Unstable trading conditions in affected regions may increase the risk that entities breach financial covenants (e.g., fail to achieve a specified level of profits or interest coverage). If such a breach occurs on or before the end of the reporting period and gives the lender the right to demand repayment within 12 months of the end of the reporting period, the liability would generally be classified as current in the borrower's financial statements.

Disclosure Considerations

[Added September 18, 2020]

ASC 470-10 does not require an entity to disclose information about short-term obligations that remain classified as long-term debt because the debtor obtains a waiver of a violation of a covenant. However, ASC 470-10-50-2 requires the disclosure of obligations classified as long-term because the debtor expects to cure a covenant violation within a specified grace period.

Renegotiation of Financial Liabilities

An increase in the number of entities experiencing financial difficulty because of events associated with the pandemic may lead to a greater number of debt restructurings (e.g., to extend a maturity, reduce a coupon rate, or ease covenant terms). Under ASC 470-50-40, a borrower must assess whether such a restructuring results in a substantially different instrument, in which case the modification is accounted for as an extinguishment of the original liability and the recognition of a new liability. ASC 470-60 provides guidance on whether a debtor should account for a debt restructuring as a TDR.

Disclosure Considerations

[Added September 18, 2020]

ASC 470-60 contains several disclosure requirements related to a debt restructuring that is a TDR. Although no specific disclosures are required under ASC 470-50 for modifications or exchanges that are not accounted for as extinguishments, an entity should consider disclosing the significant terms of any transaction involving the modification or exchange of debt, including the fact that it recognized no extinguishment gain or loss, as well as the pertinent terms of the new debt instrument involved in the transaction.

Impact on Hedge Accounting

The COVID-19 pandemic could significantly affect both (1) the ability of entities to apply hedge accounting under ASC 815 and (2) the earnings impact of hedge accounting. Entities should consider the following:

- *Whether the occurrence of forecasted transactions remains probable within the period specified in the hedge designation documentation* — For example, an entity could change its intent to make purchases or sales or may no longer have the intent or ability to roll over debt given its financial difficulties or general economic difficulties associated with the pandemic. Also, the ability of counterparties and customers to buy from or lend to the reporting entity may be adversely affected, which could limit the entity's ability to hedge certain transactions. For instance, an entity's ability to hedge probable sales to customers or probable interest payments on a loan issued by a bank may be questionable if those counterparties might be unable to perform in the current economic environment. As a result of these changes in facts and circumstances, an entity may be required to discontinue cash flow hedging (see discussion of ISDA preclearance below). A delay in the occurrence of a forecasted transaction beyond the period identified in the hedge designation documentation would also require discontinuance of cash flow hedging. ASC 815-30-40-4 requires an entity to reclassify into earnings any amounts that were previously accumulated as other comprehensive income if it is probable that the forecasted transactions will not occur within two months of the period identified in the hedge designation documentation. However, that requirement does not apply in situations in which it is probable that the transaction will still occur with a delay of more than two months after the period identified in the hedge designation documentation if the delay is

caused by "the existence of extenuating circumstances that are related to the nature of the forecasted transaction and are outside the control or influence of the reporting entity."

At the FASB's April 8, 2020, meeting, the FASB staff stated that it believes that the guidance above (i.e., on delays of a forecasted transaction caused by extenuating circumstances that are related to the nature of the forecasted transaction and that are outside the control or influence of the entity) may be applied to delays in the timing of the forecasted transactions if those delays are attributable to COVID-19. In a Q&A released on April 28, 2020, the FASB staff expanded on this view by reiterating that the exception for extenuating circumstances would apply to forecasted transactions whose delays were related to the effects of the COVID-19 pandemic. Therefore, an entity that concludes that it is probable that the forecasted transactions associated with a discontinued hedge still will occur after the additional two-month period would retain in accumulated other comprehensive income (AOCI) those amounts associated with the discontinued hedge and reclassify them into earnings in the same period(s) in which the forecasted transaction affects earnings.

The FASB staff cautioned that an entity would need to exercise judgment and consider the specific facts and circumstances related to the forecasted transaction in determining whether (1) the forecasted transaction delays were caused by the effects of COVID-19 and (2) it is probable that the forecasted transaction still will occur after the additional two-month period. As noted in the Q&A, when assessing a forecasted transaction's probability of occurrence, an entity "should consider whether the forecasted transaction remains probable over a time period that is reasonable given the nature of the entity's business, the nature of the forecasted transaction, and the magnitude of the disruption to the entity's business related to the effects of the COVID-19 pandemic." An entity that determines that it is no longer probable that the forecasted transaction will occur within the "reasonable time period beyond the additional two-month period" would immediately reclassify all AOCI amounts related to the discontinued hedge into earnings and provide appropriate disclosures in its interim and annual financial statements.

The Q&A also clarified that when an entity determines that amounts deferred in AOCI should be reclassified into earnings because of a missed forecast as a result of the COVID-19 pandemic, the entity need not consider that missed forecast in its assessment of whether it has exhibited a pattern of missed forecasts that would call into question its ability to apply cash flow hedge accounting to similar transactions in the future. An entity would need to exercise judgment and consider its specific facts and circumstances when making its determination that the missed forecast is related to the effects of the COVID-19 pandemic. For more information about the Q&A, see Deloitte's *Heads Up*, "FASB Issues Staff Q&A on the Effects of the COVID-19 Pandemic on Cash Flow Hedge Accounting."

In addition, the International Swaps and Derivatives Association (ISDA) conducted a preclearance consultation with the SEC staff related to cash flow hedging relationships involving hedging variable-rate interest payments that are deferred beyond the period specified in the hedge designation documentation as a result of the COVID-19 pandemic. The SEC staff stated that it would not object if an entity continued hedge accounting for a hedging relationship involving interest payments on variable-rate debt instruments that are deferred as a result of the COVID-19 pandemic as long as all of the following criteria are met:

- The timing of the payments is delayed but their amounts are unchanged.
- The reason for the delay in payments is COVID-19.
- It is still probable that the payments will occur.

- The hedging relationship is still highly effective.

The SEC staff emphasized that this conclusion could not be applied by analogy to any other fact patterns. At the time of this publication, the ISDA had not yet finalized the letter documenting the consultation. When the letter is finalized, it will be published on the ISDA's Web site. ***[Paragraph last amended July 8, 2020]***

Disclosure Considerations

[Added September 18, 2020]

ASC 815-10-50-4C(f) requires an entity to disclose the amounts of gains and losses reclassified into earnings as a result of the discontinuance of cash flow hedges if it is probable that the forecasted transaction will not occur by the end of the originally specified period or within the additional period discussed in ASC 815-30-40-4 and 40-5.

- *The effect of any impairment on the assessment of hedge effectiveness* — For example, the cash flows of a receivable or debt security that is hedged for interest rate risk or foreign currency risk should not be included in the hedge effectiveness assessment if they are not expected to be recovered. Entities should also carefully consider the impact of credit risk and liquidity risk on hedge effectiveness since both can be a source of hedge ineffectiveness that can cause a hedge to not be highly effective. The impact could be particularly significant on entities that have uncollateralized hedging instruments with financial institutions domiciled in affected countries (since the instruments' fair values could be significantly influenced by changes in the institutions' credit risk).
- *Whether hedging relationships in which qualitative assessment of effectiveness is being applied require a new quantitative assessment to ensure that the hedging relationship remains highly effective* — For example, if an entity is hedging the interest rate risk in a variable-rate debt instrument with an interest rate swap, and there is a floor on the variable rate in either the debt instrument or the derivative, but not in both. As interest rates continue to decline, this could have a significant impact on the assessment of hedge effectiveness.
- *The risk of counterparty default with respect to their derivative and hedging portfolios* — In accordance with ASC 815-20-35-15, if it is no longer probable that the counterparty will not default, the hedging relationship ceases to qualify for hedge accounting because it is no longer expected to be highly effective.

NPNS Election for Contracts That Meet the Definition of a Derivative

Among other criteria, for an entity to apply the normal purchases and normal sales (NPNS) scope exception in ASC 815 to a contract, the entity must be able to assert that it is probable that the contract will not net settle and will result in physical delivery both (1) at inception and (2) throughout the contract's term. Since the impacts of COVID-19 may call into question whether contracts with affected entities will physically settle, it might become more difficult for an entity to assert that such contracts meet the criteria for the NPNS election.

Disclosure Considerations

[Added September 18, 2020]

If a contract that meets the definition of a derivative no longer qualifies for the NPNS election, it must be accounted for as a derivative and, accordingly, recognized at fair value on the balance sheet. In addition, the disclosure requirements in ASC 815-10-50 for derivative instruments would apply.

Fair Value Measurement and Disclosures

ASC 820 emphasizes that fair value is a market-based measurement based on an exit price notion and is not entity-specific. Therefore, a fair value measurement must be determined on the basis of the assumptions that market participants would use in pricing an asset or liability, whether those assumptions are observable or unobservable. The fair value hierarchy in ASC 820 serves as a basis for considering market-participant assumptions and distinguishes between (1) market-participant assumptions developed on the basis of market data that are independent of the entity (observable inputs) and (2) an entity's own assumptions about market-participant assumptions developed on the basis of the best information available in the particular circumstances, including assumptions about risk inherent in inputs or valuation techniques (unobservable inputs). In accordance with the fair value hierarchy, entities are required to maximize the use of relevant observable inputs and minimize the use of unobservable inputs. This focus on the observability of inputs also often affects the valuation technique used to measure fair value.

Even in times of extreme market volatility, entities cannot ignore observable market prices on the measurement date unless they are able to determine that the transactions underlying those prices are not orderly. In accordance with ASC 820-10-35-54I, in determining whether a transaction is orderly (and thus whether it meets the fair value objective described in ASC 820-10-35-54G), an entity cannot assume that an entire market is "distressed" (i.e., that all transactions in the market are forced or distressed transactions) and place less weight on observable transaction prices in measuring fair value. See Section 10.7 of Deloitte's *A Roadmap to Fair Value Measurements and Disclosures (Including the Fair Value Option)* for more information about identifying transactions that are not orderly. At the FASB's April 8, 2020, meeting, the FASB staff reiterated that an entity would apply the guidance on orderly transactions discussed above. ***[Paragraph amended April 13, 2020]***

In addition to considering whether observable transactions are orderly, entities should take into account the following valuation matters that could be significantly affected by COVID-19:

- An evaluation of the inputs used in a valuation technique and, in particular, the need to include the current market assessment of credit risk (both counterparty and own credit risk) and liquidity risk, both for derivative and nonderivative instruments. This may also involve the need to change valuation techniques or to calibrate valuation techniques to relevant transactions.
- An assessment of whether an entity can rely on data from brokers and independent pricing services when determining fair value.

Disclosure Considerations

The disclosures required under ASC 820 are extensive, particularly those about fair value measurements involving significant unobservable inputs (i.e., Level 3). An entity may need to consider whether the impacts of COVID-19 would affect a financial instrument's level in the fair value hierarchy (e.g., a financial instrument previously classified in Level 2 would need to be transferred to Level 3 if the fair value consists of significant unobservable inputs). ASC 820 also requires an entity to (1) describe the valuation techniques and inputs used to determine fair values (by class of financial assets and liabilities) and (2) disclose a change in a valuation technique and the reason for that change.

Earnings per Share

When a contract on an entity's own equity may be settled in cash or common stock, share settlement is presumed for the diluted earnings per share (EPS) accounting in accordance with ASC 260-10-45-45. However, as discussed in ASC 260-10-55-32, if an entity (1) controls the ability to settle the contract in cash and (2) demonstrates its intent to settle the contract in cash, it may overcome the presumption of share settlement. In these situations, the entity may be required to adjust the numerator in the calculation of diluted EPS but would not include any incremental shares in the denominator of the diluted EPS calculation. For example, entities often make an assertion about the ability and intent to cash settle certain convertible debt instruments that may be settled in any combination of cash or shares at the entity's election.

As discussed in Section 4.7.2.3 of Deloitte's *A Roadmap to the Presentation and Disclosure of Earnings per Share*, in a speech at the 2003 AICPA Conference on Current SEC Developments, the SEC staff stated that an entity that controls the form of settlement should consider all of the following in determining whether it can overcome the presumption of share settlement:

- *Settlement alternatives as a selling point* — "Registrants and auditors should examine the extent to which the flexibility associated with the ability to share settle factored into senior management's decision to approve the issuance of the instrument rather than an instrument that only allowed for cash settlement."
- *Intent and ability* — "Registrants and auditors should consider the extent to which the registrant has the positive intent and ability to cash settle the face value and interest components of the instrument upon conversion. Both current and projected liquidity should be considered in determining whether positive intent and ability exists. The registrant's independent auditors should also ask for a management representation attesting to the registrant's positive intent and ability to cash settle."
- *Disclosure commensurate with intent* — "Auditors should consider the extent to which the disclosures included in a registrant's current period financial statements as well as those included in the instrument's offering documents acknowledge and support the registrant's positive intent and ability to adhere to its 'stated policy.'"
- *Past practice* — "Registrants and auditors should also examine whether the registrant has previously share settled contracts that provided a choice of settlement alternatives."

[Paragraph added April 24, 2020]

In times of economic stress, entities may need to conserve cash resources. In addition, given the economic uncertainty, entities may find it difficult to project future liquidity needs. Consequently, although the presumption of share settlement may have been overcome in prior reporting periods, it may no longer be appropriate to overcome the presumption of share settlement for contracts that may be settled in cash or stock because the entity fails to continue to have the ability or intent to cash settle such contracts. For entities that issue convertible debt instruments or other equity-linked instruments during the COVID-19 pandemic because of a need for capital, the current economic uncertainty would generally make it difficult to assert an ability and intent to cash settle those contracts. Therefore, it would typically be inappropriate to overcome the presumption of share settlement. ***[Paragraph added April 24, 2020]***

Disclosure Considerations

[Added September 18, 2020]

Entities should disclose, if material to reported diluted EPS, their intent and the judgment they applied related to determining whether cash convertible debt instruments or other cash-settleable equity-linked instruments are assumed to be settled in cash or in shares.

Revenue Contracts With Customers

[Section amended April 24, 2020]

As a result of business disruptions associated with the COVID-19 pandemic, an entity may be prevented from entering into customer agreements through its normal business practices, which may make the determination of whether it has enforceable rights and obligations challenging. In addition, because many of its customers are experiencing financial difficulties and liquidity issues, an entity may need to develop additional procedures to properly assess the collectibility of its customer arrangements and consider changes in estimates related to variable consideration (e.g., because of greater returns, reduced usage of its products or services, or decreased royalties). To help its customers or to provide incentives for them to continue purchasing its goods or services, the entity may (1) revise its agreements to reduce any purchase commitments; (2) allow customers to terminate agreements without penalty; or (3) provide price concessions, discounts on the purchase of future goods or services, free goods or services, extended payment terms, or extensions of loyalty programs. Further, because the entity itself may be experiencing financial difficulties and supply disruptions, it may (1) request up-front payments from its customers; (2) delay the delivery of goods or services; (3) pay penalties or refunds for failing to perform, not meeting service-level agreements, or terminating agreements; or (4) incur unexpected costs to fulfill its performance obligations. Therefore, as a result of the changes in circumstances experienced by both an entity and its customers due to the COVID-19 pandemic, an entity may need to consider the following when assessing revenue from contracts with customers:

- *Contract enforceability* — ASC 606-10-25-1 provides criteria that need to be met to account for a contract with a customer, including the approval of the parties to the contract and a commitment to perform their respective obligations. If the criteria are not met, no revenue can be recognized until one of the following occurs: (1) the criteria are met; (2) no obligations to transfer goods or services remain and substantially all of the consideration promised by the customer has been received and is nonrefundable; (3) the contract has been terminated and the consideration received is nonrefundable; or (4) the entity receives nonrefundable consideration, has provided the goods or services related to such consideration, has stopped providing goods or services, and has no obligation to transfer additional goods or services.

  In certain circumstances, the parties may not be able to approve a contract under an entity's normal and customary business practices. For example, the entity may not be able to obtain the signatures it normally obtains when entering into a contract because personnel from the entity or customer are unavailable or otherwise unable to provide signatures. Therefore, it is important to carefully evaluate whether the approval process creates a contract with enforceable rights and obligations between the entity and its customer. In making this determination, an entity may consider consulting with its legal counsel. If enforceable rights and obligations do not exist, revenue cannot be recognized until certain conditions are met (see above paragraph).

- *Collectibility* — A contract with a customer under ASC 606-10-25-1 does not exist unless "[i]t is probable that the entity will collect substantially all of the consideration to which it will be entitled in exchange for the [promised] goods or services that will be transferred." That consideration should not include expected price concessions

(including implied concessions), which are evaluated as variable consideration, even if those concessions are provided as a result of credit risk. In addition, while the collectibility analysis is performed at the individual contract level, an entity may look to a portfolio of similar contracts (e.g., by risk profile, size of customer, industry, geography) in its assessment. For example, if it is probable that an entity will collect substantially all the consideration for 90 percent of a portfolio of similar contracts, the entity may conclude that it has met the collectibility threshold for all the contracts in the portfolio. However, an entity should not ignore evidence related to specific contracts that do not meet the collectibility criterion. In that circumstance, it should evaluate those specific contracts separately. Further, in determining similar contracts under a portfolio approach, an entity could consider disaggregating its contracts at a more granular level than it has in the past. For example, an entity may not have historically disaggregated its contracts by industry but may reconsider its disaggregation on the basis that some industries may be more heavily affected than others (e.g., hospitality, travel).

An entity should not reassess whether a contract meets the criteria in ASC 606-10-25-1 after contract inception unless there has been a significant change in facts and circumstances. If the impacts of the COVID-19 pandemic result in a significant deterioration of a customer's or a portfolio of customers' ability to pay, the entity should reassess collectibility. For example, if a customer experiences liquidity issues or a downgrade in its credit rating, the entity would need to carefully evaluate whether those circumstances are short-term in nature or result in a determination that it is no longer probable that the customer has the ability to pay. Because of the significant uncertainty associated with the effects of the pandemic, it is important for the entity to document the judgments it made and the data or factors it considered. For example, the entity may determine that certain customers that are in financial distress will improve their liquidity position with government assistance. If the entity concludes that collectibility is not probable, a customer contract no longer exists and, thus, the entity can no longer recognize revenue, receivables, or contract assets on a prospective basis. If collectibility becomes probable in a subsequent period and the other criteria in ASC 606-10-25-1 are met, the entity can begin to recognize revenue again. See the discussion on contract enforceability above for conditions that need to be met to recognize revenue when an enforceable contract does not exist.

- *Contract modification* — An entity may modify its enforceable rights or obligations under a contract with a customer. For example, the entity may grant a price concession to a customer. In that circumstance, the entity should consider whether the concession is due to the resolution of variability that existed at contract inception (i.e., a change in transaction price associated with variable consideration) or a modification that changes the parties' rights and obligations. A price concession that is provided solely as a result of the COVID-19 pandemic most likely represents a modification that changes the parties' rights and obligations. However, if a customer has a valid expectation that it will be granted a price concession (e.g., due to past business practices or statements made by an entity), the entity should consider whether expected price concessions give rise to variable consideration that should be estimated and accounted for as a change in transaction price under ASC 606-10-32-42 through 32-45. In addition, if all performance obligations have been satisfied, any price concession would be treated as a change in transaction price.

  An entity may also modify the scope of a contract (e.g., by reducing minimum purchase commitments). If the modification adds only goods or services to the contract for an incremental fee, the entity should first evaluate whether the modification is accounted for as a separate contract under ASC 606-10-25-12. Such a modification is a separate contract if the added goods or services are priced at their stand-alone selling prices (SSPs), which may be adjusted to reflect the circumstances of the contract (e.g., a

discount due to the lack of additional selling costs). In making this determination, an entity should consider whether the SSPs of its goods or services have changed in light of the current economic environment. Any changes in the SSPs of goods or services do not affect prior contracts unless those contracts have been modified.

If the only change to a contract is a reduction of the transaction price, or if the modification is not otherwise a separate contract, the entity should evaluate the guidance in ASC 606-10-25-13 to determine whether the modification should be accounted for as (1) a termination of the old contract and the creation of a new contract because the remaining goods or services are distinct (which results in prospective treatment), (2) a cumulative catch-up adjustment to the original contract because the remaining goods or services are not distinct, or (3) a combination of (1) and (2).

- *Variable consideration* — Variable consideration includes, among other things, rebates, discounts, refunds (including for product returns), and price concessions. Under ASC 606-10-32-11, an entity should only include amounts of variable consideration in the transaction price if it is not probable that doing so would result in a significant reversal of cumulative revenue recognized when the uncertainty related to the variable consideration is resolved. Further, an entity must update its estimated transaction price in each reporting period. The entity may need to consider any expected changes in (1) its ability to perform and (2) customer behavior as a result of deteriorating economic conditions. For example, an entity may need to consider updating its estimated transaction price if it expects an increase in product returns, decreased usage of its goods or services or decreased royalties, increased invocation of retrospective price protection clauses, changes in redemption rates of coupons or volume rebates, or to potentially pay contractual penalties or liquidated damages associated with its inability to perform (e.g., the inability to deliver goods or services on a timely basis or to meet service-level agreements). In certain circumstances, an entity's estimate of penalties or liquidated damages could be limited by force majeure clauses. Further, an entity may need to reconsider whether it will be able to achieve milestone payments, performance bonuses, trailing commissions based on renewals, or other performance-related fees.

  If there is a reduction in the estimated transaction price, a change in estimate may result in the reversal of revenue for amounts previously recognized as variable consideration (e.g., as a result of an increase in return reserves). An entity may also need to allocate a reduction in the estimated transaction price to all performance obligations in a contract unless the change in estimated variable consideration is related to only one or more (but not all) performance obligations (or distinct goods or services) in accordance with ASC 606-10-32-40, 32-41, and 32-44 (e.g., penalties for late deliveries may be associated with only some of the goods or services in a contract). In addition, an entity may not need to recognize a reduction in the estimated transaction price when applying the variable consideration constraint if the reduction is too small to result in a significant reversal of cumulative revenue recognized. Because of the significant uncertainty associated with the pandemic's effects on an entity and its customers, it may be challenging for the entity to make appropriate estimates of variable consideration. Therefore, in a manner similar to its assessment of contract collectibility, an entity must document the judgments it made and the data or factors it considered.

  Further, an entity may have a right to receive noncash consideration (e.g., shares of stock) from a customer that has declined in value. Because noncash consideration is measured at its estimated fair value at contract inception, any changes in the fair value of noncash consideration after contract inception that are solely due to a

decrease in value are not variable consideration and would not be reflected in the transaction price under ASC 606-10-32-23. Rather, the noncash consideration should be accounted for under other GAAP.

- *Material right* — To mitigate any decline in sales, an entity may offer its customers sales incentives, including discounts on future goods or services. In this circumstance, the entity should evaluate whether a sales incentive on the purchase of future goods or services represents (1) a material right under ASC 606-10-55-42 that is associated with a current revenue contract (whether explicit or implicit because there is a reasonable expectation on the part of a customer that he or she will receive a sales incentive at contract inception) or (2) a discount that is recognized in the future upon redemption (i.e., when revenue is recognized for the related goods or services) in a manner consistent with ASC 606-10-32-27.

  In addition, for new or modified contracts, an entity may need to update its estimate of the SSP of a material right (e.g., because the entity extended the periods for use or provided additional incentives to a customer) or to reassess its breakage assumptions (e.g., because of extensions or changes in expected usage patterns). For example, an entity may modify its loyalty program by extending customers' ability to use points; this change may require the entity to reassess the breakage assumptions it uses.

- *Significant financing component* — To assist customers that are experiencing liquidity issues in purchasing goods and services, an entity may provide extended payment terms. Similarly, an entity with liquidity issues may require its customers to make an up-front payment in order for the entity to fulfill its promised goods or services. In those circumstances, an entity should evaluate whether a significant financing component exists under ASC 606-10-32-15 through 32-20. If an entity modifies payment terms for an existing customer contract, it should consider the same guidance on price concessions discussed above. In addition, while the extension of payment terms does not in and of itself indicate that a contract is not collectible, an entity may need to consider its procedures for assessing collectibility as noted in the Collectibility discussion above.

- *Implied performance obligations* — An entity may assist its customers by providing them with free goods or services that are not explicitly promised in the contract. In a manner consistent with ASC 606-10-25-16, an entity should determine whether its contracts with customers contain promised goods or services that are implied by its customary business practices or published policies or by specific statements that create a reasonable expectation of the customer that the entity will transfer those goods or services.

  There may also be instances in which an entity provides free goods or services to its customer that are not part of a prior contract with that customer (i.e., when the prior contract was entered into, there were no explicit or implicit obligations to provide those goods or services). An entity must carefully evaluate whether the additional promised goods or services are a modification of a preexisting customer contract or a cost incurred (e.g., marketing expense) that is separate from any preexisting contracts. We believe that in these situations, it may be helpful to consider the contract combination guidance in ASC 606-10-25-9, which specifies that contracts with the same customer (or related party of the customer) are combined if (1) they "are negotiated as a package with a single commercial objective," (2) "consideration to be paid in one contract depends on the price or performance of the other contract," or (3) there are goods or services in one contract that would be a single performance obligation when combined with the goods or services in another contract. In addition, an entity should consider the substance of the arrangement to provide the free goods or services and whether accounting for the arrangement as a separate transaction or as a contract modification would faithfully depict the recognition of revenue related

to the goods or services promised to the customer in a preexisting contract. In many cases, free goods or services provided to a customer solely as a result of the COVID-19 pandemic (that are not part of another newly entered contract with that customer) will not be considered a contract modification, particularly if they are broad based and not negotiated with the customer. However, an entity may need to determine whether it has developed a practice that creates an implied promise in future contracts.

- *Recognition of revenue* — Because of potential supply disruptions or other circumstances, an entity may need to reconsider the timing of revenue recognition if it is unable to satisfy its performance obligations on a timely basis. Revenue cannot be recognized until control of the goods or services transfers to the customer (i.e., when the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the goods or services). For example, an entity may not be able to fulfill its stand-ready obligation due to government-mandated shutdowns (e.g., the temporary shutdown of a health club). In that circumstance, the entity may need to cease recognizing revenue until it is able to perform. In addition, the entity must determine whether there are any contractual penalties that would affect the transaction price. In some cases, an entity may be completely unable to satisfy its performance obligation, which could result in (1) the termination of the contract, (2) a reversal of any revenue it previously recognized for a performance obligation that was not fully satisfied, and (3) the recognition of a refund liability (or additional liability due to a payment of penalties) instead of deferred revenue.

  Sometimes, delays in the transfer of goods or services may be caused by the customer or other external factors. For example, a customer may not be able to obtain physical possession of a product because of shipping delays or because it cannot receive the product (e.g., warehouse personnel may be unavailable). In such cases, an entity should carefully consider when control of the product transfers (e.g., before or after shipment). Further, if a customer is unable to take physical possession of the product, it may request that the entity retain the product on a bill-and-hold basis. In this circumstance, the entity would need to consider the bill-and-hold guidance in ASC 606-10-55-81 through 55-84.

  An entity may also incur unexpected costs in fulfilling a performance obligation that is satisfied over time. If that entity uses a cost-based input method to measure its progress toward complete satisfaction of the performance obligation, it should carefully consider whether the incremental costs (1) affect its measure of progress or (2) do not depict the entity's performance in transferring control of the goods or services (e.g., because the costs are due to unexpected amounts of wasted materials, labor, or other resources). Therefore, an entity may need to reevaluate the expected costs to complete its contracts and consider future material, labor, and the allocation of overhead rates.

- *Loss contracts* — An entity would not recognize a loss on a revenue contract unless it was within the scope of certain legacy U.S. GAAP, including ASC 985-605 for software arrangements, ASC 605-20 for separately priced extended warranty and product maintenance contracts, and ASC 605-35 for construction-type and production-type contracts. For example, an entity that has construction-type or production-type contracts within the scope of ASC 605-35 may need to consider whether an increase in its estimated costs would result in a contract loss that would need to be recognized immediately.

Disclosure Considerations

Many of the circumstances described above could affect an entity's disclosures. These include (but are not limited to) disclosures of significant changes in the contract asset due to an impairment, significant payment terms (including any significant financing component), and the timing of when an entity expects to recognize revenue for its remaining performance obligations (which would exclude terminated contracts or transactions that do not meet the criteria in ASC 606-10-25-1 to be accounted for as a customer contract). Given the level of uncertainty caused by the COVID-19 pandemic, an entity may find it challenging to make certain critical estimates. Therefore, it is important for the entity to disclose any significant judgments it made in accounting for its revenue contracts (e.g., assessing collectibility; estimating and constraining variable consideration; measuring obligations for returns, refunds, and other similar obligations; measuring progress toward completion of a performance obligation recognized over time; and determining the SSPs and breakage assumptions for material rights).

For health care providers, the CARES Act introduced legislation that could affect the amount of future reimbursements from third-party payors (e.g., Medicare and Medicaid), which could require affected entities to reevaluate their estimates of variable consideration. In addition, health care providers may receive advance payments from Medicare for services yet to be rendered. These advance payments would typically be recorded as a contract liability (e.g., deferred revenue). However, if any material amounts of advance payments are expected to be refunded instead of being applied to future services, such amounts would be recorded as a refund-type liability.

The CARES Act also allows federal agencies to reimburse federal contractors and subcontractors for certain payroll costs associated with paid leave or sick days. This provision could also require affected entities to reevaluate their estimates of variable consideration. For more information, see Deloitte's *Heads Up*, "Highlights of the CARES Act."

Exit or Disposal Cost Obligations

As a result of the impacts of COVID-19, entities may incur costs associated with exit or disposal activities (e.g., involuntary employee termination benefits in accordance with a one-time benefit arrangement or costs to consolidate or close facilities and relocate employees). ASC 420 provides guidance on determining when to recognize such costs and the accompanying information that must be disclosed in the notes to financial statements that include (1) the period in which an exit or disposal activity is initiated and (2) any subsequent periods until the activity is completed. See the Employee Termination Benefits section for further discussion of the accounting for involuntary termination benefits associated with ongoing employee benefit plans.

Loss Contingencies

ASC 450 defines a loss contingency as "[a]n existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur." Instability in the economy resulting from COVID-19 may cause entities to incur losses that should be recognized, disclosed, or both.

All loss contingencies (including incurred but not reported [IBNR] claims such as those related to medical care) should be evaluated under ASC 450-20 unless the contingency is within the scope of other authoritative literature that specifically prescribes an alternate accounting model. ASC 450-20 requires accrual of a loss contingency when (1) it is probable that a loss has been incurred and (2) the amount can be reasonably estimated. To accrue a loss contingency, an entity must determine the probability of the uncertain event and demonstrate

its ability to reasonably estimate the loss associated with it. Loss contingencies that do not meet both recognition criteria may need to be disclosed in the financial statements. Given the general uncertainty associated with the COVID-19 pandemic, entities may find it challenging to develop estimates for loss contingencies. For example, an entity that is self-insured for medical claims may have difficulty estimating its IBNR liability if it concludes that historical claim patterns may not be representative of future expected claims because of the COVID-19 pandemic.

Disclosure Considerations

Under ASC 450-20-50, entities must disclose both recognized and unrecognized contingencies, if certain criteria are met. In some situations, disclosure of the nature of the accrual and amount accrued may be necessary to prevent the financial statements from being misleading. For unrecognized contingencies, disclosure of the nature of the contingency and an estimate of the possible loss or range of loss (or a statement that an estimate cannot be made) is required in certain situations. Specifically, disclosure is called for if there is a reasonable possibility that a loss may be incurred but has not been accrued in the financial statements because the amount is not probable or reasonably estimable. Disclosure is also required if there is a reasonable possibility of unrecorded losses in excess of the amount accrued in the financial statements.

Recognition of Losses on Firmly Committed Executory Contracts

At the inception of a firmly committed executory contract, both parties to the contract expect to receive benefits that are equal to or greater than the costs to be incurred under the contract. Because of the impacts of COVID-19, the fair value of the remaining contractual rights of a firmly committed executory contract may unexpectedly decline below the remaining costs, resulting in a firmly committed executory loss contract. For example, an entity engaged to provide services to its customer in accordance with a firmly committed executory contract may experience a significant increase in the cost of providing the services (e.g., lack of availability of personnel to provide services resulting in the use of higher outsourced labor cost), which could result in an overall loss on the contract. We generally believe that in the absence of specific guidance to the contrary (e.g., a firm purchase commitment for goods or inventory under ASC 330 or certain executory contracts subject to ASC 420 related to exit or disposal activities), it is inappropriate to accrue for a loss related to a firmly committed executory contract.

Future Operating Losses

An entity may forecast operating losses for a certain period as a result of the COVID-19 pandemic. Such losses may result from declines in customer demand or disruptions in the supply chain. Future operating losses do not meet the definition of a liability nor do they qualify for accrual under ASC 450-20. Instead, they should be reflected in the period in which the related costs are incurred.

Contractual Penalties

Disruption to operations as a result of the COVID-19 pandemic may contribute to an entity's breach of contractual arrangements, such as revenue and supply contracts, and potentially trigger penalties owed to the counterparty (e.g., a liquidated damage provision). The obligation to pay a penalty in such a scenario does not represent a contingent loss under ASC 450-20 but rather should be accounted for as a contractual liability. The probability of payment is irrelevant if settlement of the liability is required by law or by contract. That is, other than deferred revenues, liabilities established by law or contract should be recorded at their stated amounts unless the guidance in U.S. GAAP (e.g., ASC 420) requires otherwise. If an entity is required by current laws, regulations, or contracts to make a future payment associated with

an event that has already occurred, that event imposes a present duty upon the entity. An entity's uncertainty about whether an obligee will require performance does not (1) allow the entity to choose to avoid the future sacrifice or (2) relieve the entity of the obligation. Once recognized, a contractual or legal liability that is not deferred revenue (i.e., a contract liability under ASC 606) should be derecognized only once the conditions for liability derecognition in ASC 405-20-40-1 have been met (i.e., relief through repayment, or through a legal release either judicially or by the creditor).

Insurance Recoveries

Entities that incur losses stemming from the COVID-19 pandemic may be entitled to insurance recoveries. For example, losses associated with increased medical claims, asset impairments, or shareholder litigation may be considered insured losses by many entities. Furthermore, entities may have business interruption insurance that provides coverage for lost profits due to a suspension of its operations.

Insured Losses

If an entity incurs a loss attributable to the impairment of an asset or to the incurrence of a liability and it expects to recover all or a portion of that loss through an insurance claim, the entity should record an asset for the amount for which recovery from the insurance claim is considered probable (not to exceed the amount of the total losses recognized). The entity should subsequently recognize amounts greater than those for which recovery from an insurance claim was initially deemed probable only to the extent that those amounts do not exceed actual additional covered losses or direct, incremental costs incurred to obtain the insurance recovery. A conclusion that a potential insurance recovery is probable may involve significant judgment and should be based on all relevant facts and circumstances. In determining whether it is probable that an insurance recovery will be received, an entity will most likely need, among other factors, to understand the solvency of the insurance carrier and have had enough dialogue and historical experience with the insurer related to the type of claim in question to assess the likelihood of payment. Other potential challenges an entity may encounter when evaluating whether a loss is considered recoverable through insurance include, but are not limited to, (1) the need to consider whether losses stemming from a pandemic are specifically excluded as a covered event, (2) the extent of coverage and limits, including multiple layers of insurance from different carriers, and (3) the extent, if any, to which the insurance carrier disputes coverage. Consultation with legal counsel may also be necessary.

Connecting the Dots

We believe that while applicable to SEC registrants, the following guidance from footnote 49 of SAB Topic 5.Y[9] applies to all entities evaluating an insured loss that is contested by the insurance carrier:

> The staff believes there is a rebuttable presumption that no asset should be recognized for a claim for recovery from a party that is asserting that it is not liable to indemnify the registrant. Registrants that overcome that presumption should disclose the amount of recorded recoveries that are being contested and discuss the reasons for concluding that the amounts are probable of recovery.

Any expected recovery that is greater than covered losses or direct, incremental costs incurred represents a gain contingency and therefore has a higher recognition threshold. An entity should generally recognize insurance proceeds that will result in a gain when the proceeds are realized or realizable, whichever is earlier. Such insurance proceeds are realized when the insurance carrier settles the claim and no longer contests payment. Payment alone does not mean that realization has occurred if such payment is made under protest or is subject to refund.

[9] SEC Staff Accounting Bulletin (SAB) Topic 5.Y, "Accounting and Disclosures Related to Loss Contingencies."

Business Interruption

Recent events associated with the COVID-19 pandemic have led many entities to temporarily suspend operations for reasons ranging from supply chain disruption to, on a broader scale, state and local government orders requiring individuals to shelter in place and temporarily cease operations. Business interruption insurance differs from other types of insurance coverage in that it is designed to protect the prospective earnings or profits of the insured entity. That is, business interruption insurance provides coverage if business operations are suspended because of the loss of use of property and equipment resulting from a covered loss. Business interruption insurance also generally provides for reimbursement of certain costs and losses incurred during the interruption period. Such costs may be analogous to losses from property damage and, accordingly, it may be appropriate to record a receivable for amounts whose recovery is considered probable. We encourage entities to consult with their independent auditors in connection with their evaluation of whether a receivable may be recorded for expected insurance recoveries associated with fixed costs incurred during an interruption period.

The loss of profit margin is considered a gain contingency and should be recognized when the gain contingency is resolved (i.e., the proceeds are realized or realizable). Because of the complex and uncertain nature of the settlement negotiation process, such recognition generally occurs at the time of final settlement or when nonrefundable cash advances are made.

Classification of Insurance Recoveries

ASC 220-30-45-1 addresses other income statement presentation matters related to business interruption insurance from the perspective of classification and allows an entity to "choose how to classify business interruption insurance recoveries in the statement of operations, as long as that classification is not contrary to existing [U.S. GAAP]."

For presentation within the statement of cash flows, ASC 230-10-45-21B indicates that "[c]ash receipts resulting from the settlement of insurance claims, excluding proceeds received from corporate-owned life insurance policies and bank-owned life insurance policies, shall be classified on the basis of the related insurance coverage (that is, the nature of the loss)." For example, insurance settlement proceeds received as a result of claims related to a business interruption should be classified as operating activities.

Lease/Rent Concessions

[Section last amended May 7, 2020]

As a result of the COVID-19 pandemic, certain entities are experiencing significantly reduced consumer traffic in retail stores and shopping areas or indefinite closures as a result of quarantine measures and other government directives. Lessees in some affected markets are receiving rent abatements or other economic incentives and have raised questions about the appropriate accounting. In particular, entities have asked whether such consequences give rise to a lease modification — and thus full application of the modification framework in ASC 840 or ASC 842 — or whether they can be accounted for outside of the modification framework (e.g., as the resolution of a contingency or variable rent expense or income).

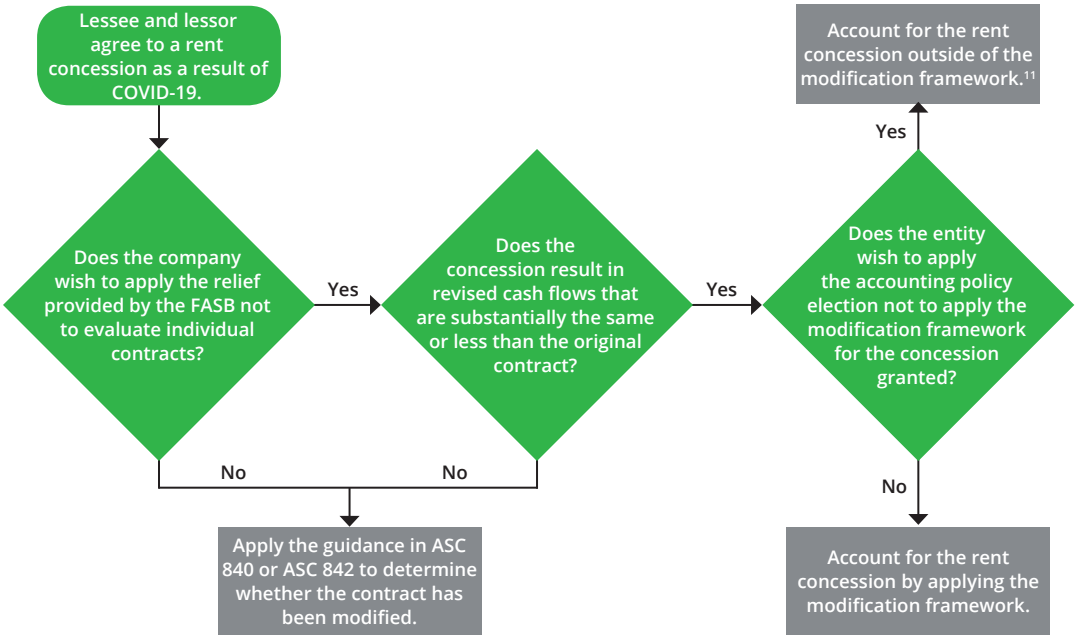
Generally speaking, under ASC 840 or ASC 842, economic relief that was agreed to or negotiated outside of the original agreement most likely represents a lease modification, in which case both the lessee and lessor would be required to apply the respective modification frameworks. However, if the lessee was entitled to the economic relief because of either contractual or legal rights, the relief would be accounted for outside of the modification framework.

Without relief related to applying the guidance, an entity would most likely need to perform legal analysis to determine whether contractual provisions in an existing lease agreement provide enforceable rights and obligations related to lease concessions. Given the significant number of leases potentially affected for certain preparers and the volume of contracts that need to be analyzed, this evaluation could become both costly and highly complex for preparers, particularly for smaller companies and those without internal legal counsel. This analysis could be even more complex in jurisdictions in which the local government implements programs that permit or require forbearance.

In the absence of interpretive guidance, the FASB staff acknowledged at the April 8, 2020, Board meeting that determining whether concessions provided to lessees constitute a lease modification under either ASC 842 or ASC 840 would be costly for both lessees and lessors. Accordingly, while the guidance in these standards takes into account lease concessions made in the ordinary course of business, the FASB believes that the guidance did not contemplate wide-ranging and rapidly executed concessions that result from a global pandemic. Further, the staff acknowledged that the economics of these concessions may not be aligned with the underlying premise of the modification framework, under which the concession would be recognized over the remainder of the lease term.

The FASB thus determined that it would be appropriate for entities to make a policy election regarding how to account for lease concessions resulting directly from COVID-19. Rather than analyzing each lease contract individually, entities can elect to account for lease concessions "as though the enforceable rights and obligations for those concessions existed, regardless of whether those enforceable rights and obligations for the concessions explicitly exist in the contract."[10] Accordingly, entities that choose to apply the relief provided by the FASB can either (1) apply the modification framework for these concessions in accordance with ASC 840 or ASC 842 as applicable or (2) account for the concessions as if they were made under the enforceable rights included in the original agreement and are thus outside of the modification framework. Therefore, in making this election, an entity would not need to perform a lease-by-lease analysis to evaluate the enforceable rights and may instead simply treat the change as if the enforceable rights were included or excluded in the original agreement. However, the staff observed that the election not to apply modification accounting is only available when total cash flows resulting from the modified contract are "substantially the same or less" than the cash flows in the original contract. The FASB did not define "substantially the same" but expects companies to apply reasonable judgment in such situations. Further, the Board emphasized that clear and concise disclosure of the accounting policy election remains integral to allow stakeholders to understand the election chosen and the resulting financial reporting implications. Finally, we understand, on the basis of discussions with the SEC staff, that the staff would not object if an entity treats "forgiveness or deferrals" either as a contract modification or as if the concession was made under the enforceable rights included in the original agreement. In a manner similar to the FASB, the SEC would limit this option to activity that is both directly related to COVID-19 and does not result in a substantive increase in the remaining contract consideration. The above accounting guidance and optional election are illustrated in the following decision tree.

[10] Quoted text transcribed from the FASB's meeting.



On April 10, 2020, the FASB issued a staff Q&A[12] (the "Staff Q&A") to provide guidance on its remarks at the April 8, 2020, Board meeting about accounting for rent concessions resulting from the COVID-19 pandemic. Specifically, the Staff Q&A affirms the guidance provided at the April 8 meeting by allowing entities to forgo performing the aforementioned legal analysis to determine whether contractual provisions in an existing lease agreement provide enforceable rights and obligations related to lease concessions as long as the concessions are related to COVID-19 and the changes to the lease do not result in a substantial increase in the rights of the lessor or the obligations of the lessee. In addition, the Staff Q&A affirms that entities may make an election (the "Election") to account for eligible concessions, regardless of their form, either by (1) applying the modification framework for these concessions in accordance with ASC 840 or ASC 842 as applicable or (2) accounting for the concessions as if they were made under the enforceable rights included in the original agreement and are thus outside of the modification framework.

The sections below address frequently asked questions about how an entity should account for COVID-19-related concessions, including certain questions from lessees and lessors regarding the scope and application of the Staff Q&A.

Connecting the Dots — The Election Also Applies to ASC 840

Although the sections below focus on the accounting under ASC 842, the Election and interpretations described below can be applied by entities that have not yet adopted ASC 842. However, the ASC 840 accounting framework, including the modification framework, is significantly different, particularly for lessees (operating leases do not have recognized lease liabilities), so outcomes under ASC 840 may differ significantly from those discussed in this publication.

Bridging the GAAP — Practical Relief Under IFRS 16

At its April 17, 2020, meeting, the International Accounting Standards Board (IASB®) also discussed providing "practical relief" that would give lessees "an optional exemption from assessing whether a COVID-19-related rent concession is a lease modification." (The IASB issued an exposure draft related to this topic on April 24, 2020.) A lessee applying this exemption would account for such a rent concession as

[11] Entities should consult with their accounting advisers regarding the acceptability of the model applied to account for the concession when not applying the modification framework.

[12] FASB Staff Q&A, *Topic 842 and Topic 840: Accounting for Lease Concessions Related to the Effects of the COVID-19 Pandemic*.

if it was not a lease modification under IFRS 16.[13] That said, there are key differences between the IASB's tentative decisions about practical relief under IFRS 16 and the FASB's guidance under ASC 842 (e.g., the proposed relief under IFRS 16 is only for lessees). See the IASB's Web site and educational materials for further background on its proposed relief and standard-setting process.

Interpretive Guidance — Staff Q&A

The response to Question 1 of the Staff Q&A states, in part:

> This election is available for concessions related to the effects of the COVID-19 pandemic that do not result in a substantial increase in the rights of the lessor or the obligations of the lessee. For example, this election is available for concessions that result in the total payments required by the modified contract being substantially the same as or less than total payments required by the original contract.

As outlined in the decision tree above, to be within the scope of the Staff Q&A, the concession must meet two criteria: (1) it must be related to the effects of COVID-19 and (2) it must cause the total payments in the modified contract to be substantially the same as or less than those in the original contract. The subsections below address the scope of the Election and how an entity is expected to apply it to various rent concessions.

Election Applicable to All Entities as Lessees and Lessors

The Election applies to all entities, including both lessees and lessors. However, because the Election is optional, an entity can choose not to take it and instead can evaluate each lease arrangement for which it has made a concession as a result of the COVID-19 pandemic to determine whether the concession reflects (1) a modification or (2) the resolution of existing contractual rights. Generally speaking, under ASC 840 or ASC 842, economic relief that was agreed to or negotiated outside of the original agreement most likely represents a lease modification, in which case both the lessee and lessor would be required to apply the respective modification frameworks. However, if the lessee was entitled to the economic relief because of either contractual or legal rights, the relief would be accounted for outside of the modification framework. See below for a discussion of various approaches that lessors and lessees may use to account for a concession outside of the modification framework.

Portfolio of Leases

The response to Question 3 of the Staff Q&A states, in part:

> [I]n accordance with paragraph 842-10-10-1, entities should apply Topic 842 consistently to leases with similar characteristics and in similar circumstances. Therefore, entities should apply reasonable judgment in applying that paragraph to lease concessions related to the effects of the COVID-19 pandemic.

Accordingly, we believe that applying the Election to some, but not all, leases may be acceptable. That said, we believe that in a manner consistent with other ASC 842 practical expedients, this Election should be applied to a portfolio of leases rather than on a lease-by-lease basis. In our view, leases can be grouped into portfolios on the basis of the following characteristics and circumstances (not all-inclusive):

- Type of concession.
- Role in the arrangement (lessor or lessee).
- Underlying asset class.

[13] International Financial Reporting Standard (IFRS) 16, *Leases*.

Specifically, as indicated in the list above, we believe that an entity that is both a lessee and lessor is not required to make the same Election for its lessee leases as it does for its lessor leases. However, an entity should apply a reasonable method that does not reflect an effort to simply manage earnings.

We believe that other acceptable alternatives may exist and that an entity should apply reasonable judgment in grouping leases.

Applicability of Election to Prior and Future Periods

We understand that some lessors and lessees may have agreed to rent concessions before the FASB provided guidance on the Election. In addition, because of the uncertainty about the duration of the COVID-19 pandemic, entities may agree to additional concessions in the future. To the extent that such prior or future rent concessions meet the two scope criteria, we believe that entities may apply the Election. That said, as discussed in the Portfolio of Leases section, the Election must be applied consistently to leases with similar characteristics and in similar circumstances. An entity should carefully consider its initial approach (i.e., an entity's first election) to applying the Election to lease portfolios and should consistently apply this approach to eligible current and future concessions.

Interpretive Guidance — Total Payments

As described in the response to Question 1 of the Staff Q&A, the Election applies to rent concessions related to COVID-19 for which the total payments in the modified contract are substantially the same as or less than total payments required by the original contract.

The Staff Q&A indicates that an entity should exercise reasonable judgment when evaluating whether the total payments are "substantially the same as or less." The following subsections address considerations related to performing this evaluation.

Consideration of Fixed and Variable Payments

We believe that when an entity is evaluating whether total payments are "substantially the same as or less," the entity should generally consider the variable payments (even if they are not included in lease payments under ASC 842) as well as the fixed payments.

Consideration of Lease Term

We believe that when evaluating total payments, an entity should consider the total payments the lessee is expected to make on the basis of the existing lease term, including any future periods subject to lessee-controlled options that were previously deemed reasonably certain to be exercised and, thus, included in the lease term. That is, the entity should evaluate the total payments over the lease term as determined under ASC 842, not the contractual term.

Entire or Remaining Lease Term

In our view, it is acceptable to measure the total payments on the basis of either the entire lease term (i.e., from commencement through expiration) or the remaining lease term (i.e., from the concession date through expiration). Although measuring the lease payments on the basis of the entire lease term should result in a greater amount (which would give the entity more flexibility when determining whether the total payments are "substantially the same or less"), we expect that the information an entity needs to measure total payments for the remaining lease term will be more readily available. The selected approach should be applied consistently to all concessions.

We believe that under either approach, it will be important to perform a qualitative assessment to validate that the change to the contract (e.g., extension of existing term) is consistent with and representative of a concession directly related to COVID-19.

The following examples illustrate the consideration of the lease term in the evaluation of total payments:

Example 1

Assume that a lease contract includes a noncancelable period of 10 years and three five-year renewal options. Both the lessee and lessor determined that the lease term was the noncancelable period of 10 years. A concession was granted when there were three years remaining in the noncancelable period (i.e., the lease term). In evaluating total payments, it would be acceptable for both parties to consider the variable and fixed payments related to (1) the entire lease term (i.e., 10 years) or (2) the remaining lease term (i.e., three years). Although the payments related to the three five-year renewal options were outlined in the original contract, such payments were not accounted for as rights of the lessor or obligations of the lessee and, therefore, should not be considered.

Example 2

Assume the same facts as in Example 1, except that the lessee, at commencement, deemed the first five-year renewal option to be reasonably certain. That is, the lessee's lease liability and ROU asset reflected 15 years and eight years of lease payments as of the commencement date and concession date, respectively. The lessor, however, did not deem any of the three five-year renewal options to be reasonably certain. In the lessee's evaluation of total payments, it would be acceptable to consider the variable and fixed payments related to either the entire lease term of 15 years or the remaining lease term of eight years. In the lessor's evaluation of total payments, it would be acceptable to consider the variable and fixed payments related to either the entire lease term of 10 years or the remaining lease term of three years. In other words, because the existing lease terms are not aligned, the lessee and lessor would not complete the same analysis and, thus, may reach a different outcome.

Discounting of Total Payments

We believe that in the evaluation of total payments, it is acceptable to measure the payments on a discounted or undiscounted basis.

Extension to the Term of the Lease

We understand that there are scenarios in which lessors are agreeing to forgive rent for a certain period if the lessee agrees to extend the existing lease term by the same period for which rent has been forgiven. For example, if an existing lease expires in 14 months, the lessor may agree to forgive the next two months of rent if the lease is extended by two months so that it instead expires in 16 months.

We believe that this type of concession would qualify for the Election (provided that the other criteria are met). However, an entity will need to evaluate total payments carefully in extension scenarios. Specifically, the entity should consider whether the total payments required by the modified contract are substantially the same as or less than those required by the original contract (particularly when the lease payments for the added months are higher than the forgiven lease payments [e.g., as a result of interest or escalators]).

Bifurcation of Changes Is Not Permissible

We do not believe that it would be acceptable to bifurcate a rent concession and any other change executed simultaneously when assessing whether the rent concession is within the scope of the Election. For example, in performing such an assessment, it would not be acceptable to bifurcate a rent concession that includes (1) a deferral of three months of payments (which would meet the scope criteria for the Election) and (2) a five-year term extension (which would not meet the scope criteria for the Election).

Sequential Concessions

In certain scenarios, a lessor may provide concessions repeatedly over current and future periods (e.g., on a rolling basis over a period of several months) because of the uncertainty regarding the duration of the COVID-19 pandemic. We do not believe that an entity is required to aggregate all previous rent concessions subject to the Election when assessing whether a current rent concession is within the scope of the Election (e.g., in the evaluation of total payments). However, when a future concession is negotiated as part of a current concession and both relate to the same underlying asset (i.e., the concessions are executed on a rolling basis but were agreed to as a package), we think that an entity should evaluate the concessions in the aggregate when computing the total payments required by the modified contract. Specifically, entities are not allowed to execute concessions sequentially simply to circumvent the scope of the Election.

Interpretive Guidance — Other

Reassessment of Lease Classification

ASC 842-10-25-1 requires an entity to reassess classification if there is a change in the lease term, regardless of whether that change results from a modification. However, we understand that the intent of the Election was, in part, to give entities relief from having to reassess lease classification for qualifying concessions. Therefore, we believe that if the Election is applicable and an entity chooses to account for the concession outside of the modification framework, the entity is not required to reassess the lease classification even if the concession amends the lease term.

Lessee's Short Payments

We understand that there are scenarios in which the lessee does not pay or only partially pays a lessor and the "short payment" is neither formally accepted as a concession by the lessor nor allowable within the original lease agreement. We generally believe that in these circumstances, both the lessee and the lessor should continue to account for the lease in accordance with the enforceable terms in the original lease because the lessee is still contractually required to make those payments and the lessor maintains a contractual right to those amounts. As a result, a lessee's expense will remain unchanged and the short payment will be reflected as an increase in the lessee's payable balance unless and until the lessor agrees to the concession. That is, the lessee does not preemptively derecognize a liability for a short payment that was not agreed to by the lessor. A similar method (recognizing revenue and a corresponding receivable) may also be acceptable for the lessor; however, the lessor should consider, similarly to how it considers other pricing disputes between parties, whether it is valid for the lessee to expect that a price concession will be granted. In addition, a short payment may be a relevant indicator in the lessor's collectibility assessment. See the Collectibility section for further considerations.

Lessor Concession Offers

We understand that there are scenarios in which the lessor has conveyed a valid expectation that it will accept a lower amount of consideration in light of the COVID-19 pandemic but a final concession has not been reached because the lessee is seeking more economic relief. In these circumstances, it may not be appropriate for the lessor to recognize revenue and a receivable for amounts reasonably expected to be conceded (e.g., if a lessor made an offer to concede some or all of its consideration).

Disclosure Considerations

[Added September 18, 2020]

The response to Question 4 of the Staff Q&A states that entities "should provide disclosures about material concessions granted (lessors) or received (lessees) and the accounting effects to enable users to understand the nature and financial effect of the lease concessions related to the effects of the COVID-19 pandemic." Further, we believe that under the disclosure objective and requirements in ASC 842, an entity would also generally need to consider whether it should disclose information about its accounting for material rent concessions. Accordingly, entities should ensure that they disclose key judgments so that users of financial statements understand the accounting implications of concessions provided by lessors or received by lessees. While such requirements are not prescriptive, an entity should consider whether its disclosures give users the ability to understand both the current and future impact of its accounting policy for concessions on financial reporting results and cash flows. In addition, disclosures should clearly and concisely describe how the accounting policy for concessions has affected management's judgment and estimation.

Such disclosures may include, but are not limited to, the types of concession received or granted, the entity's choice to take the Election, how the Election was applied to the entity's lease population, and how financial statement line items were affected (or will be affected) as a result of the concession and Election applied. In addition, public companies should ensure that their disclosures related to concession activity take into account the SEC disclosure guidance on the COVID-19 pandemic and its impact on the entity's operations. Sections of the financial statements in which an entity may be required to provide supplemental disclosures to acknowledge the implications of concessions granted or received may include the following (list is not all-inclusive):

- Management's Discussion & Analysis:
  - Overview/Outlook.
  - Results of Operations.
  - Critical Accounting Policies.
  - Liquidity subsections.
- Financial statement footnotes:
  - Significant Accounting Policies.
  - Recent Accounting Pronouncements.
  - Lease Accounting.
  - Contingencies/Subsequent Events.
- Controls and Procedures.

Finally, lessors facing heightened uncertainty related to collectibility should evaluate whether and, if so, how their disclosures address their accounting and policies related to collectibility risk, including which arrangements are subject to either (1) CECL (sales-type and direct financing leases) or (2) the guidance in ASC 842 (operating leases). They should also determine how their disclosures address the impact that COVID-19 and concession activity have had on a lessor's general reserve method and the presentation of reserved amounts in the financial statements when the lessor has elected to incorporate a general reserve for its operating leases.

Lessees — Approaches to Applying the Election

We believe that there are multiple acceptable approaches to accounting for a rent concession when the lessee applies the Election and chooses to account for the rent concession as if it were part of the enforceable rights and obligations of the existing lease contract rather than as a modification. We have described several acceptable approaches below in a scenario in which lease payments are deferred and repaid throughout the existing term of the lease. In addition, we think that there are other scenarios in which some or all of the approaches outlined may be applicable, such as rent abatement (i.e., the rent is solely forgiven) or rent forgiveness and extension of the term for the period of rent forgiveness (i.e., the scenario in the Extension to the Term of the Lease section).[14]

Please note that these approaches only apply when the concession meets the scope criteria described above. This is not a comprehensive list of all acceptable approaches, and we encourage companies to consult with their accounting advisers to determine the acceptability of any alternative methods in light of their specific facts and circumstances.

Payable Approach

The lessee would not remeasure the lease liability and ROU asset. The lessee would not amend the lease expense and would continue to amortize the lease liability and ROU asset while ignoring the concession. However, instead of recognizing a decrease in cash for the lease payment during the concession period (the deferred payment), the lessee would recognize a payable. When the lessee makes the lease payment that was deferred in connection with the concession, this payment would offset the payable.

Resolution of a Contingency Approach

The lessee would remeasure the lease in a manner consistent with any other resolution of a contingency remeasurement based on the changed timing of the unpaid lease payments. Specifically, the lessee would remeasure the lease liability on the basis of the revised lease payments[15] by using the original discount rate (i.e., the discount rate used to measure the lease before the concession) and would adjust the ROU asset by the amount of the remeasurement of the lease liability.[16] When remeasuring the lease liability to reflect a change in lease payments because of the resolution of a contingency, the lessee would not update the discount rate or reassess lease classification.

Variable Lease Expense Approach

The lessee would not remeasure the lease liability and ROU asset. The lessee would not amend the lease expense and would continue to amortize the lease liability and ROU asset while ignoring the concession. However, instead of recognizing a decrease in cash for the lease payment during the concession period, the lessee would recognize a negative variable lease expense. As a result, the net effect on the lessee's income statement would equal the difference between the periodic lease cost and the concession as negative variable lease expense in the concession period. Further, the lease liability would be reduced even though the liability has not been extinguished. When the lessee makes the lease payment that was deferred in connection with the concession, the lessee would recognize variable lease expense.

[14] In all scenarios, a lessee should evaluate whether there is an impairment indicator for its ROU asset. See Section 8.4.4 of Deloitte's *A Roadmap to Applying the New Leasing Standard* for additional guidance on impairment of an ROU asset.

[15] In remeasuring the lease liability, the lessee should remeasure other variable lease payments that are based on an index or a rate by using the index or rate on the remeasurement date.

[16] The ROU asset cannot be reduced below zero; any excess would be recognized in net income.

Application of Approaches to Finance and Operating Leases

Because the Staff Q&A does not address or differentiate between specific lease classifications, we believe that the Election applies equally to leases classified as finance leases and those classified as operating leases. Further, the acceptable approaches to accounting for rent concessions discussed above apply to both types of leases.

Connecting the Dots — Lessee May Apply Modification Accounting

As a reminder, entities can account for concessions that are within the scope of the Election, regardless of their form, either by (1) applying the complete modification framework for these concessions in accordance with ASC 840 or ASC 842 as applicable or (2) accounting for the concessions as if they were made under the enforceable rights included in the original agreement and are thus outside of the modification framework. That is, it is acceptable for the lessee to choose to account for the concession as a lease modification if the lessee takes that Election. Accordingly, the lessee would be required to apply all the modification guidance, including that on reassessing lease classification and updating the discount rate, among other things (i.e., no shortcuts are provided).

See Section 8.6 of Deloitte's *A Roadmap to Applying the New Leasing Standard* for additional guidance on applying the modification framework from the lessee's perspective.

The example below further illustrates the aforementioned approaches.

Example 3

Lessor and Lessee enter into a lease agreement for a noncancelable lease term of 36 months. Fixed lease payments at inception are $10,000 per month, payable in arrears, with a monthly escalator of $100. The lease is classified as an operating lease. Lessee measures the lease liability by using a discount rate of 6 percent. The lease liability and ROU asset are initially recognized and measured at $384,466. The lessee will recognize monthly straight-line lease expense of $11,750.[17]

As a result of the COVID-19 pandemic, Lessor agrees to give Lessee a concession in the form of payment deferrals. Accordingly, Lessee will not be required to pay the monthly rent for the second quarter of 202X (periods 18 through 20). Instead, Lessee will repay Lessor for these monthly payments on a straight-line basis over the next six months (i.e., periods 21 through 26). No other terms or conditions in the original lease agreement are modified.

The payments affected by the concession, summarized on a quarterly basis for simplicity, are as follows:

Period	Contractual Payment	Concession	Revised Payment
18–20	35,400	(35,400)	—
21–23	36,300	17,700	54,000
24–26	37,200	17,700	54,900

[17] Monthly straight-line expense of $11,750 is determined on the basis of total lease payments of $423,000 over the noncancelable lease term of 36 months.

Example 3 (continued)

The amortization table for periods 18 through 26 before the concession, summarized on a quarterly basis for simplicity, would have been as follows:

		Lease Liability				ROU Asset		
Period	Lease Cost	Beginning Balance	Liability Accretion	Lease Payment	Ending Balance	Beginning Balance	ROU Asset Reduction	Ending Balance
18–20	35,250	(227,567)	(3,254)	35,400	(195,421)	211,417	(31,996)	179,421
21–23	35,250	(195,421)	(2,765)	36,300	(161,887)	179,421	(32,485)	146,937
24–26	35,250	(161,887)	(2,255)	37,200	(126,942)	146,937	(32,995)	113,942

Payable Approach

Under the payable approach, Lessee would not remeasure the lease liability. Accordingly, the following journal entries, summarized on a quarterly basis for simplicity, show the payable that would be recognized by Lessee during the deferral period and offset during the subsequent payback periods:

Quarter 2 (periods 18–20)

Straight-line lease cost	35,250	
Lease liability		3,254
ROU asset		31,996
Lease liability	35,400	
Concession payable		35,400

Quarter 3 (periods 21–23)

Straight-line lease cost	35,250	
Lease liability		2,765
ROU asset		32,485
Concession payable	17,700	
Lease liability	36,300	
Cash		54,000

Quarter 4 (periods 24–26)

Straight-line lease cost	35,250	
Lease liability		2,255
ROU asset		32,995
Concession payable	17,700	
Lease liability	37,200	
Cash		54,900

Example 3 (continued)

Variable Lease Expense Approach

Under the variable lease expense approach, Lessee would not remeasure the lease liability. Accordingly, the following journal entries, summarized on a quarterly basis for simplicity, show the variable lease cost that would be recognized by Lessee during the deferral and subsequent payback periods:

Quarter 2 (periods 18–20)

Straight-line lease cost	35,250	
Lease liability		3,254
ROU asset		31,996
Lease liability	35,400	
Variable lease cost		35,400

Quarter 3 (periods 21–23)

Straight-line lease cost	35,250	
Lease liability		2,765
ROU asset		32,485
Variable lease cost	17,700	
Lease liability	36,300	
Cash		54,000

Quarter 4 (periods 24–26)

Straight-line lease cost	35,250	
Lease liability		2,255
ROU asset		32,995
Variable lease cost	17,700	
Lease liability	37,200	
Cash		54,900

Example 3 (continued)

Resolution of a Contingency Approach

Under the resolution of a contingency approach, Lessee remeasures the lease liability on the basis of the revised lease payments by using the original discount rate (i.e., 6 percent) and adjusts the ROU asset by the amount of the remeasurement of the lease liability. Accordingly, the lease liability is reduced from $227,567 to $226,791, and the ROU asset is reduced by this difference of $776 from $211,417 to $210,641. The updated amortization table for periods 18 through 26, summarized on a quarterly basis for simplicity, is as follows:

		Lease Liability				ROU Asset		
Period	Lease Cost*	Beginning Balance	Liability Accretion	Lease Payment	Ending Balance	Beginning Balance	ROU Asset Reduction	Ending Balance
		(227,567)				211,417		
		776				(776)		
18–20	35,250	(226,791)	(3,419)	—	(230,210)	210,641	(31,831)	178,810
21–23	35,250	(230,210)	(3,201)	54,000	(179,411)	178,810	(32,049)	146,761
24–26	35,250	(179,411)	(2,431)	54,900	(126,942)	146,761	(32,819)	113,942

* In this example, the lease cost did not change because total lease payments were not revised.

The following journal entries, summarized on a quarterly basis for simplicity, reflect the remeasured lease and show the lease payments that would be recognized by Lessee during the deferral and subsequent payback periods:

Quarter 2 (periods 18–20)

Lease liability	776	
ROU asset		776
Straight-line lease cost	35,250	
Lease liability		3,419
ROU asset		31,831

Quarter 3 (periods 21–23)

Straight-line lease cost	35,250	
Lease liability		3,201
ROU asset		32,049
Lease liability	54,000	
Cash		54,000

Quarter 4 (periods 24–26)

Straight-line lease cost	35,250	
Lease liability		2,431
ROU asset		32,819
Lease liability	54,900	
Cash		54,900

Lessors — Approaches to Applying the Election

In line with the discussion above from the lessee's perspective, we believe that when a lessor applies the Election and the lessor chooses to account for the rent concession as if it were part of the enforceable rights and obligations of the existing lease contract rather than as a modification, there are multiple acceptable approaches to accounting for the rent concession. We have described two acceptable approaches below in a scenario in which lease payments are deferred and repaid throughout the existing term of the lease. We also believe that there are other scenarios in which one or both of the approaches outlined may be applicable, such as rent abatement (i.e., the rent is solely forgiven) or rent forgiveness and extension of the term for the period of rent forgiveness. The approaches discussed below do not represent a comprehensive list of all acceptable methods, and we encourage companies to consult with their accounting advisers to determine the acceptability of any alternative methods in light of their specific facts and circumstances.

Variable Lease Income Approach

In a manner similar to the variable lease expense approach described in the section on lessees above, we believe that one acceptable approach a lessor could apply in accounting for rent concessions would be to record the impact of the concession as variable lease income in the period in which it is incurred. Thus, the lessor would record negative variable lease income in the periods in which the deferred or forgiven rent payments are provided to the lessee. If amounts are deferred, the lessor would record positive variable lease income in the periods in which the deferred amounts are paid back by the lessee. Variable lease income should not be recognized until the period in which the original payment was due or subsequent repayment is received. Straight-line lease revenue recorded by the lessor would be unchanged, and only the variable lease income would be affected by the deferral or forgiveness of rent. As a result, the net effect on the lessor's income statement would be the difference between the straight-line lease revenue and the negative variable lease income in the concession period, resulting in lower (or zero if step rents are not present) revenue in periods in which the rent is conceded.

Receivable Approach[18]

We believe that if rental payments are deferred, it would be acceptable for a lessor to account for the deferral as if no change to the lease agreement had occurred. Lease income would continue to be recognized throughout the term of the lease as originally expected, and the lessor would not recognize any variable lease income. Rather than recognizing cash during the concession period, the lessor in an operating lease would simply increase its lease receivable for amounts deferred. When the lease payment is subsequently paid, the lessor would then reduce the receivable.

Application of Approaches to Sales-Type or Direct Financing Leases

While the above discussion is from the perspective of a lessor in an operating lease, we believe that when a lessor chooses to account for rent concessions that are within the scope of the Election outside of the modification framework, these approaches may also be applied to leases classified as sales-type or direct financing leases.

[18] In our description of this approach, we have assumed that the collectibility of lease payments remains probable after the rent concession. For more information about a lessor's assessment of collectibility in light of COVID-19-related concessions, see the Collectibility section and Section 9.3.9.2 of Deloitte's *A Roadmap to Applying the New Leasing Standard*.

Connecting the Dots — Interest Income Recognition for Sales-Type or Direct Financing Leases

In a separate technical inquiry, the FASB staff addressed the recognition of interest income when a lender provides a "loan payment holiday" to borrowers who are affected by the COVID-19 pandemic. The loan payment holiday allows borrowers to temporarily stop payments, and interest does not accrue while the holiday is in effect. The staff discussed two alternatives in response to how the lender should recognize interest income. In one view, under which the continued recognition of interest income would be allowed during the loan payment holiday, lenders would calculate a new effective interest rate that equates the revised remaining cash flows to the carrying amount of the original debt. This method would be applied prospectively for the remaining term. In a second view, the lender would be able to recognize no interest income during the payment holiday and then resume recognizing interest income when the payment holiday ended. While that technical inquiry did not address lessor accounting, we think that both views would be acceptable applications of the Election for lessors accounting for similar concessions on direct financing and sales-type leases. Other applications of the Election may also be acceptable for direct financing and sales-type leases.

Connecting the Dots — Lessor Election to Apply Modification Accounting

As a reminder, entities can account for concessions that are within the scope of the Election, regardless of their form, either by (1) applying the complete modification framework for these concessions in accordance with ASC 840 or ASC 842 as applicable or (2) accounting for the concessions as if they were made under the enforceable rights included in the original agreement and are thus outside of the modification framework. That is, it is acceptable for the lessor to choose to account for the concession as a lease modification if the lessor takes that Election. Accordingly, the lessor would be required to reassess lease classification in accordance with ASC 842-10-25-9 and remeasure and reallocate the remaining consideration as of the modification date in accordance with ASC 842-10-35-41.

See Section 9.3.4 of Deloitte's *A Roadmap to Applying the New Leasing Standard* for further guidance on applying the modification framework from the lessor's perspective.

The following example illustrates the approaches discussed in the scenario in which lease payments are deferred and repaid throughout the existing term of the lease. Please note that these approaches only apply when the concession meets the necessary scope criteria outlined above.

Example 4

Assume the same facts as in Example 3 above.

Variable Lease Income Approach

Under this approach, the lessor recognizes (1) negative variable lease income in the periods for which payments are deferred and (2) positive variable lease income in the periods for which the payments are increased. Straight-line lease revenue is otherwise unchanged as a result of the concession. This approach is illustrated in the following chart, summarized on a quarterly basis for simplicity:

Period	Original Billings	(Deferral)/ Payback	Revised Billings	Straight-Line Lease Revenue	Variable Lease Revenue	Change in Lease Receivable	Total Lease Receivable
18–20	35,400	(35,400)	—	35,250	(35,400)	(150)*	16,000
21–23	36,300	17,700	54,000	35,250	17,700	(1,050)	14,950
24–26	37,200	17,700	54,900	35,250	17,700	(1,950)	13,000

* The change in the receivable in the concession period reflects the net impact of the straight-line lease revenue offset by the negative variable lease revenue.

To account for the variable lease income recognized throughout the deferral and subsequent payback periods, the lessor will record the following journal entries on a quarterly basis:

Quarter 2 (periods 18–20)

Variable lease revenue	35,400	
Straight-line lease revenue		35,250
Lease receivable		150

Quarter 3 (periods 21–23)

Cash	54,000	
Straight-line lease revenue		35,250
Variable lease revenue		17,700
Lease receivable		1,050

Quarter 4 (periods 24–26)

Cash	54,900	
Straight-line lease revenue		35,250
Variable lease revenue		17,700
Lease receivable		1,950

Example 4 (continued)

Receivable Approach

Under the receivable approach, the lessor continues to recognize straight-line lease revenue in a manner that is unchanged from the original lease agreement and does not record any variable lease income. Rather, the lessor records an increased receivable in the periods of the deferrals and reduces that receivable in the subsequent periods in which the deferred amount is paid back. This approach is illustrated in the following chart, summarized on a quarterly basis for simplicity:

Revised Lease

Period	Billings	(Deferral)/ Payback	Revised Billings	Straight-Line Lease Revenue	Change in Lease Receivable	Total Lease Receivable
18–20	35,400	(35,400)	—	35,250	35,250	51,400
21–23	36,300	17,700	54,000	35,250	(18,750)	32,650
24–26	37,200	17,700	54,900	35,250	(19,650)	13,000

In addition, the lessor records the following journal entries in each quarter to properly account for the increased receivable:

Quarter 2 (periods 18–20)

Lease receivable*	35,250	
Straight-line lease revenue		35,250

* The net increase to the lease receivable of $35,250 reflects an increase for unpaid billing of $35,400, partially offset by a decrease to the straight-line lease receivable of $150 ascribed to the lessor's original straight-line revenue calculation.

Quarter 3 (periods 21–23)

Cash	54,000	
Straight-line lease revenue		35,250
Lease receivable*		18,750

* The net decrease to the lease receivable of $18,750 reflects cash repayment of previously deferred amounts of $17,700 and a decrease to the straight-line lease receivable of $1,050 ascribed to the lessor's original straight-line revenue calculation.

Quarter 4 (periods 24–26)

Cash	54,900	
Straight-line lease revenue		35,250
Lease receivable*		19,650

* The net decrease to the lease receivable of $19,650 reflects cash repayment of previously deferred amounts of $17,700 and a decrease to the straight-line lease receivable of $1,950 ascribed to the lessor's original straight-line revenue calculation.

Collectibility

A lessor's agreement to give a lessee a concession, regardless of its form, is not an automatic indicator that collection of lease payments for that lessee is no longer probable. However, using the Election does not remove the requirement for a lessor to assess collectibility. As with our views on pricing disputes between lessees and lessors in the normal course, we believe that the collectibility assessment is required after resolution of pricing disputes (i.e., a postconcession assessment). Given the significant economic disruption caused by the COVID-19 pandemic, the collectibility assessment is particularly important for all lessors.

Lessors should continue to evaluate whether the facts or circumstances for each individual lessee indicate that collection is no longer probable and, if so, should adjust their accounting accordingly. For additional information on a lessor's accounting for an operating lease when collectibility is not probable, including the collectibility assessment of disputed charges, see Section 9.3.9.2 of Deloitte's *A Roadmap to Applying the New Leasing Standard*.

Consolidation and Equity Method Accounting

[Section amended April 24, 2020]

The COVID-19 pandemic may give rise to specific transactions or events that could affect a reporting entity's accounting conclusions and disclosures related to consolidation as well as its equity method accounting. Such transactions or events may include the following and are discussed in greater detail in the succeeding sections:

- *Operating losses* — During the economic downturn associated with the COVID-19 pandemic, a legal entity may incur substantial operating losses that reduce the level of its equity investment at risk.
- *Change in governance rights affecting the party (or parties) with power to direct the activities of a VIE that most significantly affect the VIE's economic performance* — In the event of a legal entity's default on covenants as a result of operating losses, or if there are otherwise changes in rights or governance provisions of a legal entity related to the COVID-19 pandemic, a lender or other entity may obtain rights to participate in or make decisions of the legal entity.
- *Time lag* — If a parent reports a subsidiary's financial results on a time lag, or if an equity method investor reports an equity method investee's financial results on a time lag, there may be material intervening events arising from the COVID-19 pandemic during the period between the subsidiary's or investee's year-end reporting date and the reporting entity's balance sheet date that the reporting entity may be required to either disclose or both recognize and disclose.
- *Equity method basis differences* — The recognition of an other-than-temporary impairment charge for an equity method investment related to the COVID-19 pandemic may affect existing equity method basis differences or give rise to new ones. ***[Paragraph added May 7, 2020]***

Note that the initial assessment of whether a reporting entity has a controlling financial interest in a legal entity should be performed on the date on which the reporting entity first becomes involved with the legal entity. A reporting entity is required to reconsider whether a legal entity is a VIE upon the occurrence of certain types of events ("VIE reconsideration events") but should not reconsider whether a legal entity is a VIE on a continual basis or as a result of circumstances other than the specific events outlined in ASC 810-10-35-4. See Chapter 9 of Deloitte's *A Roadmap to Consolidation — Identifying a Controlling Financial Interest* for further discussion of VIE reconsideration events.

A reporting entity must continually reassess whether it is the primary beneficiary of a VIE throughout the entire period in which the reporting entity is involved with the VIE.[19] However, because consolidation of a VIE is based on the power to direct the activities of a VIE that most significantly affect the VIE's economic performance, it is unlikely that the primary-beneficiary conclusion will change periodically in the absence of specific transactions or events that affect the power over a VIE. See Chapter 7 of Deloitte's *A Roadmap to Consolidation — Identifying a Controlling Financial Interest* for further discussion of the identification of the primary beneficiary of a VIE.

[19] Similarly, the determination of whether a reporting entity should consolidate a voting interest entity (i.e., a legal entity that is not a VIE) is also a continual process. That is, the reporting entity should monitor specific transactions or events that affect whether it holds a controlling financial interest.

Operating Losses of a VIE

Legal entities may incur substantial operating losses during the period of economic downturn associated with the COVID-19 pandemic. Operating losses incurred by a legal entity that are in excess of its expected losses and result in a reduction of the equity investment at risk generally do not, in isolation, trigger a requirement for a reporting entity to reconsider the sufficiency of the equity-at-risk characteristic of a VIE under ASC 810-10-15-14(a). Said differently, if the amount of the equity investment at risk at the legal entity's inception (or when a reporting entity first became involved with the legal entity) was determined to be sufficient, losses later incurred by the legal entity do not, **in isolation**, cause the legal entity to become subject to the VIE guidance because of a reduction in the level of equity investment at risk.

However, reporting entities should consider whether, as an indirect result of operating losses, there is a change in governance rights that causes a corresponding change in the entity **that has the power to direct the activities** of a VIE that most significantly affect the VIE's economic performance.

Change in Governance Rights Affecting the Party (or Parties) With Power to Direct the Activities of a VIE That Most Significantly Affect the VIE's Economic Performance

An example of how the COVID-19 pandemic could affect whether a reporting entity is the primary beneficiary of a VIE is a default by the legal entity on certain provisions in its debt agreements (e.g., debt covenants or a decline in the fair value of collateral below preapproved levels). Some agreements may contain provisions that, in the event of such a default, give the lender the right to participate in or make decisions that affect the economic performance of the legal entity. Upon default, and provided that there are no substantive barriers to the lender's exercise of such rights, a reporting entity may lose its controlling financial interest in the legal entity. In such instances, other entities involved with the VIE (e.g., a lender) should also reconsider whether they have obtained a controlling financial interest in the legal entity on the basis of specific transactions or events.

A change in the party (or parties) with power to direct the activities of a legal entity that most significantly affect the legal entity's economic performance could also lead to reconsideration of whether a legal entity is a VIE. For example, a legal entity that was controlled by its equity holders may violate a covenant that provides the debt holder or a guarantor with governance rights that could call into question whether the power to direct the most significant activities of the legal entity still rests with the holders of the equity investment at risk. Such a scenario would be deemed a VIE reconsideration event. For more information, see Chapter 9 of Deloitte's *A Roadmap to Consolidation — Identifying a Controlling Financial Interest*.

Disclosure Considerations

[Added September 18, 2020]

In addition, reporting entities should consider the effect of a change in governance rights on applicable disclosures, including those related to significant judgments and assumptions made in determining the primary beneficiary of a VIE. See Section 11.2 of Deloitte's *A Roadmap to Consolidation — Identifying a Controlling Financial Interest*.

Reporting Subsidiary Results on a Time Lag — Material Intervening Events

If a parent reports a subsidiary's financial results on a time lag, and material intervening events occur as a result of the COVID-19 pandemic during the reporting time lag, the reporting entity may be required to either disclose or both recognize and disclose those events.

When a reporting entity and its subsidiary have different fiscal-year-end dates, it may be acceptable under ASC 810-10-45-12 and (if applicable) SEC Regulation S-X, Rule 3A-02, for the parent to report the subsidiary's financial results on a time lag by using the subsidiary's financial statements for its fiscal period. In such situations, the reporting entity is required to evaluate events that occur during any reporting time lag (i.e., the period between the subsidiary's or equity method investee's reporting date and the reporting entity's balance sheet date) and must either disclose all material intervening events or both disclose and recognize them (on the basis of its accounting policy election).

If the reporting entity's policy is to only disclose material intervening events, the reporting entity may nevertheless, in certain situations, be required to record some of those events in the consolidated financial statements of the parent. Examples of such situations include those in which the intervening event is considered (1) a recognized subsequent event in accordance with ASC 855-10-25-1 or (2) a significant intervening event. Significant intervening events are those events that are so significant they must be recognized to prevent the parent's consolidated financial statements from being misleading (e.g., the magnitude of the event's effect on the parent's consolidated financial statements is substantial and permanent in nature). A reporting entity should recognize such events by recording their effects in the parent's consolidated financial statements even if the reporting entity's elected policy is to only disclose material intervening events. It would generally not be appropriate to present more than 12 months of operations for the subsidiary in the consolidated financial statements (in addition to the effects of the recognized event or another change in the parent's accounting for the subsidiary).

Reporting entities must use judgment to identify, as appropriate, any material intervening events related to the COVID-19 pandemic and, if the reporting entity's policy is to only disclose material intervening events, evaluate whether any such events are so significant that their recognition would be required notwithstanding a disclosure-only policy election. See Section 11.1.3 of Deloitte's *A Roadmap to Consolidation — Identifying a Controlling Financial Interest*.

Reporting Equity Method Investee Results on a Time Lag — Material Intervening Events

If an equity method investor reports an equity method investee's financial results on a time lag, and material intervening events occur as a result of the COVID-19 pandemic during the reporting time lag, a reporting entity may be required to either disclose or both recognize and disclose those events.

In certain circumstances, it may be acceptable for a reporting entity with an equity method investment or an investment in a joint venture to account for its share of the earnings or losses of an investee by using a time lag on the basis of the guidance in ASC 323-10-35-6. It is generally acceptable for an investor that applies the equity method of accounting to report its results (i.e., its share of the earnings or losses of an investee) by using the financial statements of an equity method investee whose reporting date is different from the investor's as long as the investor's and investee's reporting dates are no greater than three months apart. In such situations, the investor should also evaluate material events that occur during the time lag (i.e., the period between the investee's most recent available financial statements and the investor's balance sheet date) to determine whether the effects of such events should be disclosed or recorded in the investor's financial statements. An investor may elect a policy of either disclosing all material intervening events or both disclosing and recognizing them. However, when an investor chooses to only disclose material intervening events, there may be events that are so significant that disclosure alone would not be sufficient. It would generally not be appropriate to include the investee's results for a period that is greater or less than 12 months.

Reporting entities must use judgment to identify, as appropriate, any material intervening events related to the COVID-19 pandemic and, if the investor's policy is to only disclose material intervening events, evaluate whether any such events are so significant that their recognition would be required notwithstanding a disclosure-only policy election. See Section 5.1.4 of Deloitte's *A Roadmap to Accounting for Equity Method Investments and Joint Ventures* and Section 11.1.3 of Deloitte's *A Roadmap to Consolidation — Identifying a Controlling Financial Interest* for further discussion of when recognition or disclosure or both are appropriate for material intervening events.

Equity Method Basis Differences

[Section added May 7, 2020]

As discussed in the Impairment and Valuation Considerations section, impairment is recognized for a loss in value of an equity method investment that is due to an other-than-temporary decline in value. The recognition of such an other-than-temporary impairment charge will often affect existing equity method basis differences[20] or give rise to new ones. For example, if an investor has a positive basis difference allocated to various assets and equity method goodwill greater than an impairment, the impairment will be likely to reduce the existing positive basis differences and affect their subsequent amortization. Conversely, if an investor does not have any positive basis differences or the other-than-temporary impairment charge exceeds the existing basis differences, the recognition of an impairment charge will result in the creation of a negative basis difference. ASC 323 does not provide guidance on how the impact of an impairment charge should be allocated to basis differences. Therefore, an investor should select an accounting policy to allocate impairment charges to basis differences and apply it consistently. See Section 5.5.2.1 of Deloitte's *A Roadmap to Accounting for Equity Method Investments and Joint Ventures* for illustrative examples of approaches to allocate impairment charges to basis differences.

Defined Benefit Plans

The significant economic uncertainty associated with the COVID-19 pandemic will affect the measurement of defined benefit obligations and plan assets, particularly when quoted prices in active markets for identical assets do not exist. Entities may be considering whether a significant decline in the value of plan assets would require interim remeasurement of a defined benefit plan before the normal annual remeasurement. Some insights into navigating the guidance are discussed below.

Interim Remeasurements

A significant decline in the fair value of plan assets is not an event that requires an interim remeasurement of a defined benefit plan. However, disclosures in the interim financial statements may be required, particularly for entities that may anticipate recognition of significant actuarial losses associated with unrealized losses on plan assets at the end of the year — especially those entities that recognize actuarial gains and losses immediately in the income statement. However, a curtailment, settlement, or material plan amendment of defined benefit plans associated with restructuring activities may trigger the need for an entity to perform an interim remeasurement before the required annual defined benefit remeasurement date. If an interim remeasurement is triggered, the entity should remeasure both the plan assets and the defined benefit obligations.

[20] An equity method basis difference is the difference between the cost of an equity method investment and the investor's proportionate share of the carrying value of the investee's underlying assets and liabilities. The investor is required to account for this basis difference as if the investee were a consolidated subsidiary. See Section 4.5 of Deloitte's *A Roadmap to Accounting for Equity Method Investments and Joint Ventures* for further discussion of equity method basis differences.

Plan Assets

An entity's considerations related to the fair value measurement of financial and nonfinancial assets also apply to the measurement of plan assets under ASC 715. Defined benefit plans may hold significant amounts of assets that do not have an active market, such as investments in hedge funds, structured products, and real estate assets that may become more illiquid, making their valuation more complex. Appropriately determining the fair value of such assets is important in the determination of the funded status of a defined plan (see the Fair Value Measurement and Disclosures discussion for further details).

Defined Benefit Obligations

The discount rate used to value defined benefit obligations under ASC 715 should be set by reference to the yield at which the benefits can effectively be settled. Typically, rates on high-quality bonds (at least AA-rated) that are available currently and expected to be available during the period in which the plan benefits will be paid have been used for this purpose.

In recent years, it has been common for entities to use either a hypothetical portfolio of high-quality corporate bonds, a yield curve based on such bonds, or the average yield on an index of corporate bonds. A volatile economic environment may present challenges to entities' use of such methods. For example, the spread of yields among the bonds comprising the hypothetical portfolio, yield curve, or published index may indicate that the market no longer considers some of the corporate bonds to be of high quality even though their credit rating has yet to be adjusted. In these circumstances, the portfolio, yield curve, or index should be adjusted to exclude the yields on such bonds. In addition, entities should be able to conclude that the results of using a shortcut to calculate the discount rate, such as an index, are reasonably expected not to be materially different from the results of using a discount rate calculated from a hypothetical portfolio of high-quality bonds.

The approach used by an entity for determining the discount rate should be applied consistently from one period to the next. Further, it may also be appropriate for the entity to consider the reasonableness of the outcome of that approach by comparing it with the outcome of other approaches used to set the discount rate. Finally, depending on the size of the obligation and the sensitivity to changes in the discount rate, an entity should consider disclosing whether its selection of a rate involved a critical judgment or significant accounting estimate.

Plan Curtailments — Furloughs

[Section added April 24, 2020]

Entities that have implemented plans to temporarily or permanently furlough employees covered by a pension plan — or those that have temporarily suspended a pension plan so that employees covered by it do not earn additional pension benefits for some or all of their future services — may need to consider whether those actions constitute a curtailment of the pension plan. A curtailment occurs if an employer's actions (1) significantly reduce the expected years of future service of the employees participating in the pension plan or (2) eliminate the accrual of defined benefits for some or all of the future services for a significant number of employees.

Because there are no bright lines to use in determining the meaning of "significantly," entities must apply judgment. In general, however, a reduction of 10 percent or more of the total years of future service, or the elimination of benefits of more than 10 percent of the employees, would be considered significant. When the decrease in expected years of future service is less than 10 percent of benefits, or some or all future services are eliminated for fewer than 10 percent of the employees, entities that conclude that a curtailment has occurred should properly document the basis for their conclusion and apply such conclusion consistently to similar fact patterns.

Disclosure Considerations

[Added September 18, 2020]

ASC 715-30-50-1 provides extensive disclosures regarding the funded status of defined benefit plans, as well as the key considerations of events during the annual period that impact the plans assets in particular when Level 3 investments are held by the plans, as well as the key actuarial assumptions that impact the measurement of the defined benefit obligations.

The CARES Act provides entities with the ability to delay making contributions associated to their defined benefit plans. Therefore, entities that may have material required contributions that will avail themselves of the 2020 deferral in contributions should disclose that fact to comply with ASC 715-30 requirements to disclose the nature and effect of the significant changes during the period affecting comparability.

Stock Compensation

[Section amended April 24, 2020]

Performance Conditions and Service Conditions

Some businesses may cease operations or operate at reduced capacity as a result of the impacts of COVID-19, which could affect the probability that performance targets for share-based payments with performance conditions will be met. ASC 718-10-25-20 requires entities to recognize compensation costs for an equity award with a performance condition in situations in which the outcome of the performance condition is probable. For example, if an award contains a performance condition that affects vesting (such as an award that vests if certain revenue and EBITDA[21] growth targets are met) and it is not probable that the performance condition will be satisfied, any previously recognized compensation cost should be reversed.

Given the economic uncertainty brought on by the COVID-19 pandemic, certain companies may elect to issue awards without immediately setting the performance targets. For example, an award may include a performance condition, but the threshold required to meet that condition may not have been set. In those situations, entities should consider the facts and circumstances and may conclude that a grant date has not been established.

The cessation of an entity's operations or a reduction in its operating capacity may affect the number of awards that are ultimately forfeited. Entities that have an accounting policy to estimate forfeitures[22] associated with service conditions should consider the impact of such business decisions on estimated forfeitures.

See Sections 3.2 and 3.4 of Deloitte's *A Roadmap to Accounting for Share-Based Payment Awards* for further discussion of determining the grant date and vesting conditions, respectively.

Market Conditions

Unlike a performance or a service condition, a market condition is not a vesting condition. A market condition is directly factored into the fair-value-based measure of an award. Regardless of whether the market condition is satisfied, an entity would still be required to recognize compensation cost for the award if the service is rendered or the good is delivered (i.e., the service or performance condition is met). Compensation cost would not be reversed due to a decline in stock prices.

[21] Earnings before interest, tax, depreciation, and amortization.

[22] An entity is required to make an entity-wide policy election for both employee awards and nonemployee awards to either (1) estimate forfeitures or (2) recognize forfeitures when they occur.

See Section 3.5 of Deloitte's *A Roadmap to Accounting for Share-Based Payment Awards* for further discussion of market conditions.

Modifications

Entities may decide to modify the terms or conditions of an equity award. If such modification leads to a change in the fair-value-based measure, vesting conditions, or classification of the award, the modification is treated as an exchange of the original award for a new award. When modification accounting is applied, entities should consider whether, at the time of modification, the award is expected to vest (i.e., vesting is probable) under the original vesting conditions and under the modified vesting conditions.

If an equity-classified award is expected to vest under both its original vesting conditions and modified vesting conditions (i.e., a probable-to-probable, Type I modification), entities may need to recognize additional compensation cost for any incremental value provided on the modification date.

If the equity-classified award was not expected to vest under its original vesting conditions but is now expected to vest under the modified vesting conditions (i.e., an improbable-to-probable, Type III modification), entities should reverse the amount of compensation cost previously recognized and recognize compensation cost by using the modification-date fair-value-based measure.

See Section 6.3 of Deloitte's *A Roadmap to Accounting for Share-Based Payment Awards* for further discussion of the impact of vesting conditions on accounting for modifications.

Expected Volatility Assumptions in an Option Pricing Model

Volatility is a measure of the amount by which a share price has fluctuated (historical volatility) or is expected to fluctuate (expected volatility) during a period. In option pricing models, expected volatility is required to be an assumption because the option's value is based on potential share returns over the option's term.

The SEC staff's Interpretive Response to Question 1 of SAB Topic 14.D.1[23] notes that entities should incorporate into the expected volatility estimate any new or different information that would be useful. Further, they should "make good faith efforts to identify and use sufficient information in determining whether taking historical volatility, implied volatility or a combination of both into account will result in the best estimate of expected volatility" of the underlying share price.

ASC 718-10-55-37(a) states that an entity may disregard the volatility of the share price for an identifiable period if the volatility resulted from a condition (e.g., a failed takeover bid) specific to the entity, and the condition "is not expected to recur during the expected or contractual term." Some entities may consider whether they can disregard the current stock market volatility brought on by the COVID-19 pandemic.

The SEC staff's Interpretive Response to Question 2 of SAB Topic 14.D.1 addresses considerations by registrants when computing historical volatility. The staff believes that an entity should be prepared to support its exclusion of a period of historical volatility as irrelevant to estimating expected volatility because the period consists of one or more discrete and specific historical events that are not expected to occur again during the term of the option. The staff believes that such exclusions would be rare. We do not believe that the broad-based stock market volatility related to the impacts of COVID-19 would qualify as a period of historical volatility that could be excluded.

[23] SEC Staff Accounting Bulletin Topic 14.D.1, "Certain Assumptions Used in Valuation Methods: Expected Volatility."

See Section 4.9.2.3 of Deloitte's *A Roadmap to Accounting for Share-Based Payment Awards* for further discussion of the expected volatility assumption in an option pricing model.

Employee Termination Benefits

[Section amended April 24, 2020]

While the CARES Act provides a number of programs to alleviate some or all of the costs associated with the unforeseen consequences of the COVID-19 pandemic (see the Government Assistance discussion for further detail), entities may nevertheless be considering (or implementing) plans to mitigate their exposure. For example, entities may take measures to reduce their workforce through temporary employee furloughs in response to the state governments' mandates to close facilities temporarily. Further, entities may be forced to consider subsequent restructuring actions as information becomes available on the long-term effects of the pandemic on the entities' operations. There are multiple accounting frameworks for the accounting for these employee benefits; therefore, entities start by identifying the nature and characteristics of each proposed action that is being considered because it may affect the timing of the recognition of the benefits provided to employees. Some of those frameworks are described below.

Salary Continuation, Temporary Suspension of Employment (Voluntary and Involuntary Furloughs)

Some entities may offer to continue to pay employees full salaries and provide regular benefits while not requiring them to provide direct services over a certain period. Other entities may initiate voluntary or involuntary furloughs, under which employees are put on temporary unpaid leave while retaining health and life insurance benefits for either a specified or undetermined period. Both the employer and the furloughed employees may expect that employees will return to provide direct services to the employer after the temporary suspension. Other employers may implement arrangements to lay off employees on a temporary or permanent basis. The guidance in U.S. GAAP does not specifically address these types of temporary arrangements. Therefore, in considering a relevant accounting framework, entities should assess the substance of the benefit offered.

For arrangements in which employees are terminated or in which the substance of the benefit is more consistent with one of the forms of termination benefits described below, it may be appropriate for an entity to apply that guidance in determining the timing of the recognition of the benefits offered.

Arrangements in which employees are not terminated may be within the scope of ASC 710 or ASC 712. The application of the appropriate accounting framework, which affects timing of recognition as well as measurement, depends on individual facts and circumstances and how the benefit is communicated to employees. If the benefit is more consistent with a compensated absence (i.e., the employer expects the employee to return to work after a temporary allowed absence), it may be appropriate to apply the guidance in ASC 710. If the benefit is more consistent with a postemployment benefit (i.e., provided to former or inactive employees), it may be appropriate to apply the guidance in ASC 712. Under both ASC 710 and ASC 712, key factors to consider are whether the benefit (1) is provided to compensate for past or future services and (2) vests or accumulates.

Under ASC 710, an entity recognizes compensation cost when (1) the right to the benefit is attributable to services already rendered, (2) the benefit vests or accumulates, (3) payment of the benefit is probable, and (4) the amount of the benefit can be reasonably estimated. If any of these criteria are not met, compensation cost is not recognized.

Under ASC 712, recognition depends on the same four criteria; however, if the benefit does not vest or accumulate, an accrual would be recognized if (1) the benefit is attributable to past services, (2) the event creating the obligation occurs, and (3) the payment of the benefit cost becomes probable and reasonably estimable in accordance with ASC 450.

Often, benefits offered to involuntarily furloughed employees do not vest or accumulate. Therefore, it is relevant to determine whether the benefit is provided in exchange for past or future services and what event obligates payment of the benefit. ASC 710 prohibits the accrual of compensation costs not attributable to services already rendered, such as when activities undertaken during sabbatical leave will provide future benefit to the employer. Accordingly, it would not be appropriate to accrue benefit costs for furloughed employees if the temporary inactivity of the employee provides a future benefit to the employer (e.g., if the employee is required to perform any activities during the furlough period or if the employee is required to stand ready to return to work during the furlough period to earn the benefit). Rather, such costs should be recognized as incurred. This approach is consistent with the guidance in Example 4 of EITF Issue 01-10,[24] which addresses compensation of employees who were temporarily unable to work as a result of the terrorist attacks of September 11, 2001. However, if an entity concludes that benefits that do not vest or accumulate are provided in exchange for past service, it may be appropriate for the entity to follow the guidance in ASC 712, which requires accrual upon the occurrence of an obligating event if the payment of the benefit is probable and reasonably estimable.

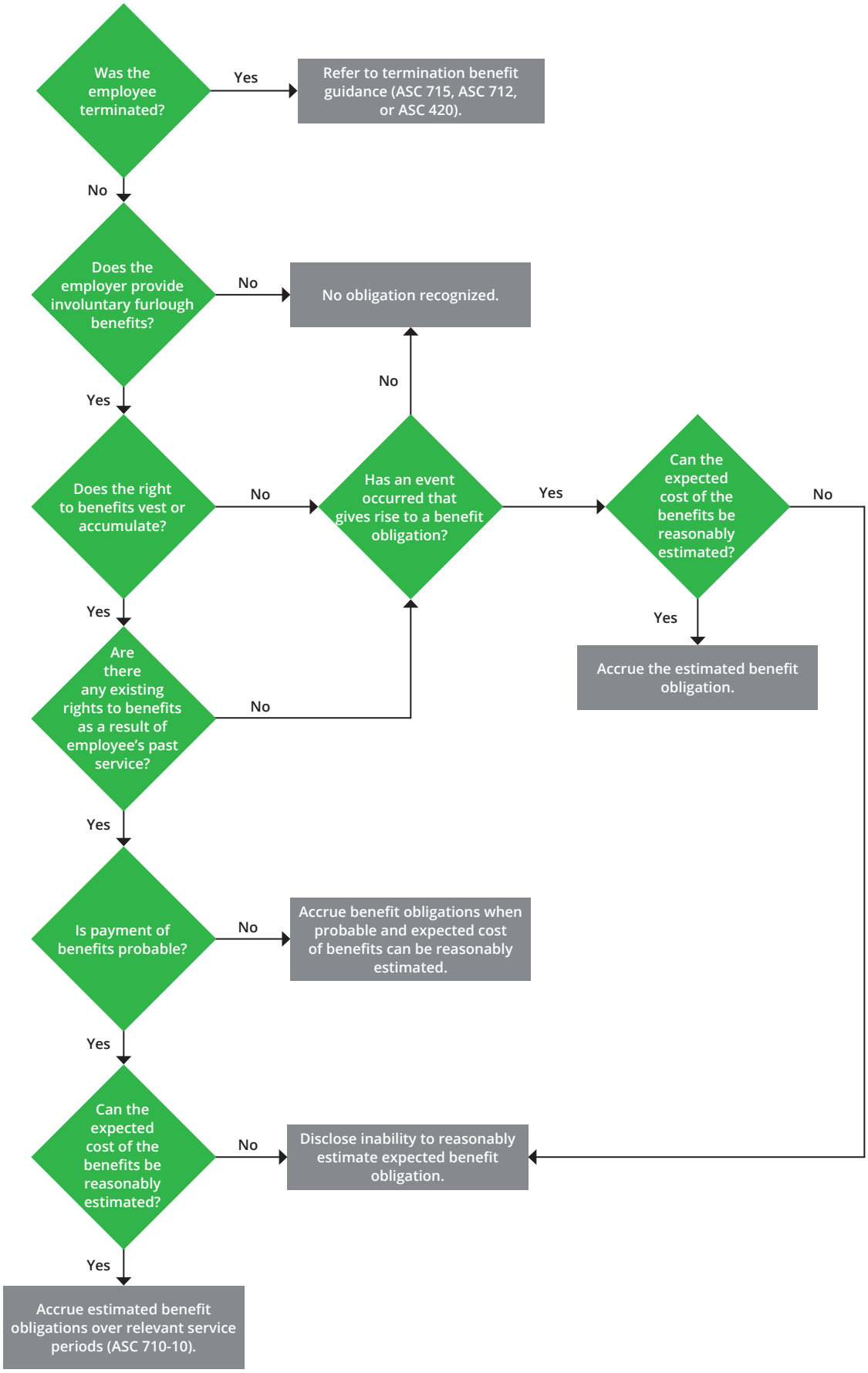
In determining whether an obligating event has occurred as a result of a furlough program, an entity should consider the following not all-inclusive list of facts and circumstances:

- The past practice of providing benefits or similar programs to employees, which may create a substantive plan.
- The direct or indirect benefits an entity may receive from retaining its existing workforce through ongoing payments.
- The nature of the information and commitments communicated to employees (e.g., fixed versus variable period, short term versus long term).
- The nature of the eligibility requirements employees must meet to continue receiving the payments (e.g., provide service at a reduced capacity or stand ready to provide service versus no service requirement, ability to seek other employment during the furlough period).
- The duration of the employee suspension, including whether the suspension is expected to be temporary or permanent.

In applying its judgment, an entity may conclude that announcement of its intent to compensate employees while they are not providing direct services is a constructive obligation that meets the definition of a liability, even if the benefit does not vest or accumulate. In this situation, accrual would depend on an entity's ability to compute a reasonable estimate of the furlough costs. Such an estimation may involve significant judgment, including estimates of forfeitures and the duration of the benefit.

[24] EITF Issue No. 01-10, "Accounting for the Impact of the Terrorist Attacks of September 11, 2001."

The following decision tree describes the key judgments that an entity should consider when determining when or if benefits to furloughed employees should be accrued or expensed as incurred, and the appropriate model to apply:



The above framework applies to involuntary termination benefits. Certain furlough programs may be voluntary. In the case of voluntary furlough benefits, an accrual should be recognized when the voluntary furlough benefit is accepted by the employee.

In addition, an entity that concludes that an accrual for health benefits offered to furloughed employees is appropriate will need to consider how it pays for those costs. For example, an entity may have transferred the insurance risk associated with those benefits to a third-party insurer and therefore will not have retained responsibility for actual claims (i.e., the premiums paid represent the total cost for the entity). Other entities may be self-insured or have insurance policies that include retroactive premiums that are subject to ASC 720, and therefore the entities will be responsible for the actual heath care costs incurred by their employees. In self-insured cases, the recognition of an expense as of the balance sheet date should be based on (1) the cost of incurred and already reported claims and (2) an estimate for expected future claims that have not been reported.

One-Time Involuntary Termination Benefits

ASC 715-30-60-3 states that "one-time termination benefits provided to current employees that are involuntarily terminated under the terms of a one-time benefit arrangement" that, in substance, is not an ongoing benefit arrangement would be accounted for in accordance with ASC 420. In general, the obligation associated with the one-time termination benefit should be measured at fair value in accordance with ASC 420-10-30-5 and should be recognized in either of the following ways:

- If the employees do not have to provide services beyond the minimum retention period, the obligation should be recognized as of the "communication date," as detailed in ASC 420-10-25-8.
- If, to receive termination benefits, the employees are required to render service until they are terminated and will be retained to render service beyond the minimum retention period, the liability should be recognized ratably over the future service period (e.g., communication date to date of termination).

Further, ASC 420-10-20 defines the communication date as "[t]he date the plan of termination . . . meets all of the criteria in paragraph 420-10-25-4 and has been communicated to employees."

Involuntary Termination Benefits as Part of an Ongoing Plan

If termination benefits to be paid to terminated employees are part of a substantive preexisting ongoing employee benefit plan (e.g., legal minimum indemnity benefits in certain countries or established severance policies), ASC 420 is not applicable. Rather, such benefits should be accounted for in accordance with other guidance, such as ASC 715-30, ASC 715-60, ASC 712, or ASC 710. Contractual termination benefits paid only upon the occurrence of a plan-specified event are within the scope of ASC 712, while termination benefits paid through a pension or postretirement plan are within the scope of ASC 715. All other involuntary termination benefits provided as part of an ongoing plan may be within the scope of ASC 712 or 710 depending on the specific terms of the plan, as described above. Involuntary benefits within the scope of ASC 715, ASC 712, and ASC 710 generally require recognition of a liability when it is probable that employees will be entitled to benefits and the amount can be reasonably estimated. That is, it is possible that the conditions to accrue the obligation may be met before the communication date required under ASC 420.

Voluntary Termination Benefits

Entities offering a voluntary termination benefit (referred to in ASC 712 as "special termination benefits") to employees in an effort to reduce their workforce should consider the guidance in ASC 712-10-25-1, which generally requires a liability and loss to be recognized "when the employees accept the offer and the amount can be reasonably estimated."

Because the accounting for involuntary termination benefits discussed above differs on the basis of the type of benefits and the circumstances under which they are provided, an entity considering providing enhanced involuntary benefits to individual employees over and above the benefits of an ongoing employee benefit plan would find itself having to apply both (1) the guidance on involuntary termination benefits of an ongoing plan and (2) ASC 420 to the enhanced benefits.

Disclosure Considerations

[Added September 18, 2020]

ASC 420-10-50 provides disclosure requirements for an entity that incurs costs associated with exit activities, including termination benefits. In addition, entities that incur liabilities associated with special or voluntary termination plans should provide the disclosures required by ASC 715-20-50 that apply to defined-benefit-type obligations.

Compensated Absences

[Section added April 24, 2020]

Entities may choose to modify their policies on short-term compensated absences (e.g., holidays, paid time off, or sick leave) for 2020 or permanently. An entity's accrual for traditional short-term compensated absences generally depends on whether (1) it has an obligation to make a payment if an employee is terminated (i.e., the benefits vest) or (2) the benefit increases as employees provide additional services (i.e., the benefits accumulate). Generally, sick leave benefits do not vest or accumulate, so compensation expense is recognized as the employee uses sick leave benefits. Further, entities are not required to accrue an obligation for nonvesting accumulating rights to receive sick leave benefits. However, they may elect to do so if (1) the right to the benefit is attributable to services already rendered, (2) payment of the benefit is probable, and (3) the amount of the benefit can be reasonably estimated. In applying judgment to the nature of any changes in policy, an entity should consider its actual practices in determining whether the benefits may vest or accumulate, thereby requiring or allowing an accrual at the time of the modification of the policy on short-term compensated absences.

Disclosure Considerations

[Added September 18, 2020]

Entities should provide disclosures when an accrual for compensated absences is not recognized because an estimate cannot be reliably made and all other conditions for accrual are met.

Risks and Uncertainties

Entities that apply accrual accounting must make estimates in current-period financial statements on the basis of current events and transactions, the effects of which may not be precisely determinable until some future period. The final results may not match original expectations. Uncertainty about the outcome of future events is inherent in economics, and that fact should be understood when reading reports on economic activities, such as published financial statements. A business, to a great extent, is a function of the environment

in which it operates. Thus, it can be affected by changing social, political, and economic factors. Further, any entity (or the industry it operates in) may be affected by uncertainties associated with future events.

Disclosure Considerations

The uncertainties discussed above may or may not be considered contingencies as defined by ASC 450-10-20; accordingly, the disclosures required by ASC 275-10-50 supplement and, in many cases, overlap those required by ASC 450-20-50. For example, some entities may be required to disclose certain significant estimates and their current vulnerability because of concentrations associated with the COVID-19 pandemic.

Certain Significant Estimates

ASC 275 states, in part, "Estimates inherent in the current financial reporting process inevitably involve assumptions about future events. . . . Making reliable estimates for those matters is often difficult even in periods of economic stability; it is more so in periods of economic volatility."

Furthermore, ASC 275 requires entities to disclose certain estimates that are susceptible to change (e.g., estimates underlying impairment assessments) if the information known and available to the entity before the financial statements are issued (or available to be issued) meet both of the following conditions:

- It is reasonably possible that the estimate will change in the near term.
- The effect of the change will be material.

Disclosure Considerations

Disclosing the information above is intended to give financial statement users an early warning that certain estimates inherent in the financial reporting process may materially change in the near term (i.e., within one year from the date of the financial statements). Entities should consider the uncertainty introduced by the impacts of COVID-19 when evaluating whether additional disclosures of certain estimates are required in the financial statements.

For additional details about ASC 275 disclosures, see the Requirement to Develop Estimates, and Consistency of Assumptions and Estimates section above.

Current Vulnerability Due to Certain Concentrations

Entities with certain concentrations are exposed to greater risk of loss relative to other entities. Examples of concentrations include those associated with:

- The volume of business with a particular customer, supplier, or lender.
- Revenue from particular products or services.
- The sources of supply of materials, labor, or services.
- The market or geographic area in which an entity conducts its business.

ASC 275-10-50-16 requires disclosure of concentrations if all the following conditions are met:

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

Entities will need to consider whether to provide concentration disclosures as a result of the impacts of COVID-19, particularly if they have met the second condition above.

Long-Term Intra-Entity Foreign Investments

ASC 830-20-35-3(b) provides an exception that allows gains and losses on certain intra-entity foreign currency transactions "of a long-term-investment nature" to be treated like translation adjustments instead of being recognized in net income. For a transaction to qualify as a long-term investment, the entity must be able to assert that "settlement is not planned or anticipated in the foreseeable future." An entity that has characterized intra-entity transactions as part of its net investment in the entity may need to reassess whether that designation is still appropriate in the current economic environment. For example, an entity that plans to undergo restructuring because of the COVID-19 pandemic may need to reassess whether certain intercompany loans that had previously been determined to be of a "long-term-investment nature" should continue to be accounted for as such if the loans could now be settled in the "foreseeable future" in connection with the restructuring plan.

Government Assistance

[Section amended April 13, 2020]

In response to the COVID-19 pandemic, domestic and international governments are considering, or may have implemented, legislation to help entities that have experienced financial difficulty associated with it. One such example is the CARES Act, which provides assistance in the form of loans, grants, tax credits, or other forms of government aid. Although some forms of assistance may be referred to as "grants" or "credits," entities should carefully look at the form and substance of the assistance to determine the appropriate accounting framework to apply. For example, assistance may be in the form of income-based tax credits that are dependent on taxable income or other forms of government assistance that is not dependent on taxable income (e.g., payroll tax credits). Income-based tax credits generally will be within the scope of ASC 740 (see the Income Taxes discussion for further details). Government assistance that is not dependent on taxable income is generally not within the scope of ASC 740 and would most likely be viewed and accounted for as a government grant.

Exchange Transaction Versus Contribution

The nature and form of government assistance may vary (e.g., grants, payroll tax credits, forgivable loans, price adjustments, reimbursements of lost revenues, reimbursements of expenses). In performing its accounting analysis, an entity should first consider whether the government assistance it receives represents an exchange transaction (i.e., a reciprocal transfer in which each party receives and pays commensurate value) or a contribution, which is defined in the ASC master glossary as an "unconditional transfer of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner." To determine whether the government assistance represents an exchange transaction, an entity should consider the factors in the table below, which is adapted from ASC 958-605-15-5A and 15-6 (as amended by ASU 2018-08).

An Exchange Transaction May Not Exist if:	An Exchange Transaction May Exist if:
(1) The benefit provided by the entity is received by the general public, (2) the government only received indirect value from the entity, or (3) the value received by the government is incidental to the potential public benefit derived from using the goods or services transferred from the entity.	The transfer of assets from a government entity is part of an existing exchange transaction between the receiving entity and an identified customer (e.g., payments under Medicare and Medicaid programs). In this circumstance, "an entity shall apply the applicable guidance (for example, Topic 606 on revenue from contracts with customers) to the underlying transaction with the customer, and the payments from the [government] would be payments on behalf of" the customer, rather than payments for benefits that were received by the general public.
The entity has provided a benefit that is related to "[e]xecution of the [government's] mission or the positive sentiment from acting as a donor."	The expressed intent was to exchange government funds for goods or services that are of commensurate value.
The entity solicited funds from the government "without the intent of exchanging goods or services of commensurate value" and the government had "full discretion in determining the amount of" assistance provided.	Both the entity and the government negotiated and agreed on the amount of government assistance to be transferred in exchange for goods and services that are of commensurate value.
Any penalties the entity must pay for failing "to comply with the terms of the [government assistance] are limited to the [goods] or services already provided and the return of the unspent amount."	The entity contractually incurs economic penalties for failing to perform beyond the government assistance provided.

If an entity concludes that the government assistance it received represents an exchange transaction, it should account for such assistance in accordance with the applicable U.S. GAAP (e.g., ASC 606). As discussed further below, certain payments may be considered part of an exchange transaction between the recipient entity and its customers. Furthermore, if a not-for-profit entity concludes that the government assistance represents a contribution, such assistance would be accounted for pursuant to ASC 958-605.

Connecting the Dots

Government assistance could include complex provisions; therefore, an entity should carefully apply judgment and consider consulting with its advisers when determining the appropriate accounting treatment. For example, an entity may conclude that assistance is (1) entirely an exchange transaction or (2) partially an exchange transaction and partially a grant. Further, some provisions may only provide for a right to defer payments (for which interest is not imputed in accordance with ASC 835-30-15-3(e)), while others may solely represent a grant from the government (e.g., reimbursement of incurred costs).

Government Grants

If the government assistance an entity receives is not accounted for under ASC 740 (e.g., an income-tax-based credit), an exchange transaction (e.g., loan, equity transaction, or revenue arrangement), or a contribution within the scope of ASC 958, it would most likely be viewed as a government contribution of assets and accounted for as a government grant.

Not-for-profit entities should apply ASC 958-605 to the government grants they receive. However, government grants to business entities are explicitly excluded from the scope of ASC 958.[25] Other than the guidance in ASC 905-605-25-1 for income replacement and subsidy programs for certain entities in the agricultural industry, there is no explicit guidance in U.S. GAAP on the accounting for government grants to business entities.

[25] See ASC 958-605-15-6(d).

In the absence of explicit guidance in U.S. GAAP for business entities, ASC 105 provides a hierarchy for entities to use in determining the relevant accounting framework for the types of transactions that are not directly addressed in sources of authoritative U.S. GAAP. According to ASC 105-10-05-2, an entity should "first consider [U.S. GAAP] for similar transactions" before considering "nonauthoritative guidance from other sources," such as IFRS Standards. As discussed further below, we understand that there may be diversity in practice.

When selecting the appropriate accounting model to apply to a government grant, a business entity should consider the specific facts and circumstances of the grant. If the entity has a preexisting accounting policy for accounting for similar government grants, it should generally apply that policy. However, if the entity does not have a preexisting accounting policy or the grant is not similar to grants it has received in the past, it should carefully consider applying a model that would faithfully depict the nature and substance of the government grant.

We believe that in the absence of either directly applicable or analogous U.S. GAAP, it may be appropriate to apply IAS 20,[26] which has been widely used in practice by business entities to account for government grants.

Connecting the Dots

While we believe that IAS 20 has been widely applied in practice by business entities in accounting for government grants, the application of ASC 450-30 may also be acceptable since we are aware that some business entities may have applied a gain contingency model by analogy for certain grants (e.g., the Electronic Healthcare Records program under the American Recovery and Reinvestment Act of 2009). Under this model, income from a conditional grant is viewed as akin to a gain contingency; therefore, recognition of the grant in the income statement is deferred until all uncertainties are resolved and the income is "realized" or "realizable." That is, an entity must meet all the conditions required for receiving the grant before recognizing income. For example, a grant that is provided on the condition that an entity cannot repurchase its own shares before a certain date may result in the deferral of income recognition until the compliance date lapses. Such a deferral may be required even if (1) the government funded the grant, (2) the entity incurred the costs that the funds were intended to defray, and (3) the remaining terms subject to compliance are within the entity's control and virtually certain of being met. That is, it would not be appropriate under a gain contingency model for an entity to consider the probability of complying with the requirements of the government grant when considering when to recognize income from the grant. Therefore, for many grants, the recognition of income under ASC 450-30 would most likely be later than the recognition of income under IAS 20.

In addition, it may be acceptable in practice to apply other U.S. GAAP for government grants. For example, while government grants to business entities are explicitly excluded from the scope of ASC 958, the FASB staff has noted that such entities are not precluded from applying that guidance by analogy when appropriate. Therefore, a business entity may conclude that it is acceptable to apply ASC 958 by analogy, particularly if the grant received by the business entity is similar to that received by a not-for-profit entity (e.g., certain subsidies provided to both nonprofit and for-profit health care providers).

Further, some may believe that loans obtained should be accounted for as debt in their entirety under ASC 470, even if all or a portion of the loan is expected to be forgiven. Under ASC 405-20, income would not be recorded from the extinguishment of the loan until the entity is legally released from being the primary obligor. Alternatively, an entity

[26] For titles of IFRS Standards, see the list on the IFRS Web site.

may account for the loan as an in-substance government grant if it is probable that the loan will be forgiven. ***[Paragraph amended September 18, 2020]***

IAS 20 Accounting Framework

An entity that elects an IAS 20 framework to account for government grants should consider that such grant cannot be recognized (even if payment is received up front) until there is reasonable assurance that the entity will (1) comply with the conditions associated with the grant and (2) receive the grant. While "reasonable assurance" is not defined in IAS 20, for a business entity that is subject to U.S. GAAP, we believe that reasonable assurance is generally the same threshold as "probable" as defined in ASC 450-20 (i.e., "likely to occur").

When an entity has met the reasonable assurance threshold, it applies IAS 20 by recognizing the government grant in its income statement on a "systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate." To help an entity meet this objective, IAS 20 provides guidance on two broad classes of government grants: (1) grants related to long-lived assets (capital grants) and (2) grants related to income (income grants).

Capital Grants

A capital grant is a grant received by an entity with conditions tied to the acquisition or construction of long-lived assets. An entity may elect an accounting policy to initially recognize such a grant as either deferred income or a reduction in the asset's carrying amount. If the entity classifies the grant as deferred income, it will recognize the grant in the income statement over the useful life of the depreciable asset that it is associated with (e.g., as an offset against depreciation expense). If the entity classifies the grant as a reduction in the asset's carrying amount, the associated asset will have a lower carrying value and a lower amount of depreciation over time. Further, with respect to nondepreciable assets, IAS 20 observes that "[g]rants related to non-depreciable assets may also require the fulfilment of certain obligations and would then be recognised in profit or loss over the periods that bear the cost of meeting the obligations. As an example, a grant of land may be conditional upon the erection of a building on the site and it may be appropriate to recognise the grant in profit or loss over the life of the building."

Income Grants

An income grant is a grant that is not related to long-lived assets. An entity may present the receipt of such a grant in the income statement either as (1) a credit to income (in or outside of operating income) or (2) a reduction in the related expense that the grant is intended to defray. As discussed above, the main objective of the accounting for government grants under IAS 20 is for an entity to recognize a grant in the same period or periods in which it recognizes the corresponding costs in the income statement. Therefore, an entity should assess the specific compliance requirements that it must meet to receive or retain any funds from the government.

Connecting the Dots

Income-related government grants that are intended to compensate for expenses incurred over time may also include over time compliance requirements. Applying IAS 20 could therefore allow for over time recognition of the grant if the entity can assert that it is likely to comply with the conditions (i.e., the grant is reasonably assured).

However, if an entity instead applied the ASC 450-30 gain contingency framework to these types of grants, recognition of the government grant would generally be delayed until all conditions were met because the probability of compliance is not taken into consideration in the application of ASC 450-30.

While IAS 20 identifies two broad classes of grants, it is worth noting that some grants may include multiple requirements and have aspects of both capital grants and income grants. That is, such grants may be intended to subsidize the purchase of long-lived assets and certain operating costs. Therefore, an entity receiving a grant that is subject to multiple requirements should carefully assess how to allocate such a grant into components on a systematic and rational basis to accomplish the overall objective of matching recognition of the grant to recognition of the cost in the income statement.

Statement of Cash Flows

When an entity receives a capital grant, the timing of the cash payment it receives from the government for long-lived assets could affect the cash flow classification. If the entity receives the cash after it has incurred the capital costs, it would be appropriate to present the cash inflow from the government in the same category (i.e., investing) as the original payment for those long-lived assets. However, if the government provides the funds before the expenditures have been incurred, it would be appropriate for the entity to present that cash inflow as a financing activity because receiving the cash before incurring the related cost would be similar to receiving a refundable loan advance. In addition, when the entity incurs the costs in accordance with the conditions of the government grant, it should disclose the existence of a noncash financing activity resulting from the fulfillment of the grant requirements.

Similarly, if an entity receives an income grant as reimbursement for qualifying operating expenses, the grant would be presented in the statement of cash flows as an operating activity if it was received after the operating expenses were incurred. However, some entities may believe that in cases in which cash is received before the qualifying operating expenses are incurred, it would be appropriate to present the cash inflow as a financing activity for the advance (e.g., forgivable loans) in a manner consistent with the guidance above. Alternatively, others may believe that it is acceptable to present the cash inflow as an operating activity if the entity expects to comply with the terms of the grant (e.g., an advance on future payroll taxes credit) so that both the inflow and outflow are presented in the operating category.

Disclosure Considerations

Although there currently is no authoritative guidance in U.S. GAAP on disclosure requirements for government grants received by business entities, the FASB initiated a project in 2015 to address disclosures that entities should provide for government assistance they receive. In 2015, the Board issued a proposed ASU[27] that described several disclosures that it considered relevant and useful to stakeholders. Such disclosures included a general description of the significant categories of government assistance and disclosures of (1) the form in which the assistance has been or will be received, (2) the financial statement line items that are affected (noting that such assistance may be presented as a separate line in the statement of operations), (3) significant terms and conditions of the government assistance, and (4) any government assistance received but not recognized directly in the financial statements. While the project continues to be listed on the FASB's active agenda, there is no scheduled date for further redeliberations. In the absence of authoritative guidance, we believe that it is critical for an entity to disclose its accounting policy for government grants, and the financial statement line items that are affected, if the grant amounts are material to its financial statements.

See Deloitte's *Heads Up*, "Highlights of the CARES Act," for further information and financial reporting considerations related to government assistance associated with the CARES Act.

[27] FASB Proposed Accounting Standards Update, *Disclosures by Business Entities About Government Assistance*.

Income Statement Classification Considerations

Entities may need to determine whether the financial effects (i.e., incremental operating gains or losses) stemming from the COVID-19 pandemic should be reported or disclosed in the financial statements as a separate component of income from continuing operations.

Under ASC 220-20-45-1, if an entity concludes that a material event is of an unusual nature or occurs infrequently (or both), the entity must either report the nature and financial effects of the event as a separate component of income from continuing operations or provide disclosure in the notes to the financial statements. Under this guidance, "unusual nature" represents a situation in which the underlying event has a high degree of abnormality and not related to the ordinary activities of the entity. Furthermore, "infrequency of occurrence" represents an event that would not reasonably be expected to recur in the foreseeable future. We believe that most companies will consider COVID-19 to be unusual or infrequent and that a decision about whether to separately disclose related amounts would therefore primarily be based on the materiality of the impact on its financial statements.

ASC 220-20 does not provide guidance on assessing how the financial effects of a qualifying event should be disclosed; accordingly, a registrant may need to use significant judgment when determining the amounts to separately report or disclose. We believe that in determining how to report such amounts, an entity could reasonably conclude that disclosing direct and incremental costs or benefits related to the COVID-19 pandemic would be consistent with the spirit of the guidance above (e.g., asset impairments, cleaning costs, business interruption insurance recoveries). However, as businesses begin to reopen and recover, it may become more difficult for them to objectively determine the unusual costs related to COVID-19. New internal controls may need to be implemented along with such presentation. ***[Paragraph amended July 1, 2020]***

Income statement presentation for public companies is also addressed in SEC Regulation S-X, Rule 5-03,[28] for commercial and industrial companies. In certain instances, the SEC has given registrants flexibility in disaggregating the components of required line items on the face of the statement of comprehensive income. Registrants that are significantly affected by the COVID-19 pandemic may consider presenting a separate line item or line items on their statement of comprehensive income to show the impact of this unusual or infrequent event. To the extent that an entity elects to present a separate line item or line items on its statement of comprehensive income, we encourage it to transparently disclose both the nature and amount of all costs included in the line item(s) in the footnotes to the financial statements and in MD&A.

Connecting the Dots

COVID-19-related items that are presented separately on the face of the income statement may not fully correlate with acceptable adjustments in a registrant's non-GAAP measure (i.e., a line item may be appropriate for separate presentation, but some components of the line item may not be allowable adjustments in a non-GAAP measure). See discussion above. ***[Added July 1, 2020]***

Registrants that present a separate line item or line items for the impact of COVID-19 should consider the effect on gross profit or operating income subtotals presented. For example, while a subtotal for gross profit is not required by Rule 5-03, certain costs such as inventory impairment are expected to be part of costs of sales (and therefore included in gross profit) by analogy to ASC 420-10-S99-3. In addition, under Rule 5-03, a subtotal for operating income is not required on the face of the income statement; but if a registrant presents a subtotal for operating income, it should generally present any COVID-19-related line item as part of

[28] For titles of and links to SEC Regulation S-X rules, see the e-CFR Web site.

operating income.[29] Further, we believe that a separately presented COVID-related line item should not be preceded by a subtotal such as "income before COVID-related amounts" (even if the subtotal is presented without a caption).

Going-Concern Disclosures

COVID-19 is significantly disrupting the operations of many businesses. Entities will need to consider whether such disruption will be prolonged and result in diminished demand for products or services or significant liquidity shortfalls (or both) that, among other things, raise substantial doubt about whether the entity may be able to continue as a going concern.

As part of performing this assessment, management may need to consider whether the entity's financial statements should continue to be prepared on a going-concern basis (i.e., whether ASC 205-30 is applicable). Even more importantly, management must consider whether (on the basis of ASC 205-40), (1) there are conditions and events that, when considered in the aggregate, raise substantial doubt about the entity's ability to continue as a going concern within one year after the date on which the interim or annual financial statements are issued and (2) these conditions are able to be mitigated by management's plans.

ASC 205-40 requires an entity to provide disclosures in the **annual** and **interim** financial statements when events and conditions are identified that raise substantial doubt about the entity's ability to continue as a going concern within one year after the financial statements are issued. Such disclosures are required even when management's plans alleviate such doubt about the entity's ability to continue as a going concern. If management's plans do not alleviate substantial doubt about the entity's ability to continue as a going concern, in addition to the required disclosures, management must state in the notes to the financial statements that there is substantial doubt about the entity's ability to continue as a going concern within one year after the date on which the annual or interim financial statements are issued.

As indicated in ASC 205-40-55-2, assessing whether there is substantial doubt about an entity's ability to continue as a going concern may involve the consideration of factors such as the following:

a. Negative financial trends, for example, recurring operating losses, working capital deficiencies, negative cash flows from operating activities, and other adverse key financial ratios [Some of these items, such as working capital deficiencies and short-term negative cash flows from operating activities, may directly apply to an entity affected by COVID-19.]

b. Other indications of possible financial difficulties, for example, default on loans or similar agreements, arrearages in dividends, denial of usual trade credit from suppliers, a need to restructure debt to avoid default, noncompliance with statutory capital requirements, and a need to seek new sources or methods of financing or to dispose of substantial assets [These items may or may not apply to an affected entity.]

c. Internal matters, for example, work stoppages or other labor difficulties, substantial dependence on the success of a particular project, uneconomic long-term commitments, and a need to significantly revise operations [Among these items, project dependence and long-term commitments would perhaps be the most applicable to an affected entity.]

d. External matters, for example, legal proceedings, legislation, or similar matters that might jeopardize the entity's ability to operate; loss of a key franchise, license, or patent; loss of a principal customer or supplier; and an uninsured or underinsured catastrophe such as a hurricane, tornado, earthquake, or flood. [These circumstances are probably the most relevant to affected entities but also the most unpredictable given the unprecedented nature of the pandemic.]

[29] However, to the extent that an entity concludes that a nonoperating gain or loss is COVID-related, we would expect the gain or loss to remain a nonoperating item (i.e., the classification as "COVID-related" does not change the characteristic of the gain or loss as operating versus nonoperating).

Subsequent Events

[Section amended September 18, 2020]

Given the economic environment and the likelihood that events may occur rapidly or unexpectedly, entities should carefully evaluate information that becomes available after the balance sheet date but before the issuance of the financial statements. ASC 855-10-25-1 and ASC 855-10-25-3 provide the following guidance on evaluating subsequent events:

> An entity shall recognize in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. See paragraph 855-10-55-1 for examples of recognized subsequent events.
>
> An entity shall not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date but before financial statements are issued or are available to be issued. See paragraph 855-10-55-2 for examples of nonrecognized subsequent events.

Often the "events" are (1) company specific and (2) associated with a specific account that permits a more precise analysis. However, sometimes the "events" are macroeconomic in nature (such as those resulting from COVID-19) and have a pervasive impact on many estimates in a set of financial statements, which may make it difficult to ascertain whether such conditions "existed" on the balance sheet date. The medium-term and long-term effects of the COVID-19 pandemic on economic activity are still unknown. However, COVID-19 will be a factor in an entity's analysis of estimates residing in the financial statements, including, but not limited to, estimates related to receivable reserves, obsolescence reserves, impairment analyses, variable and contingent compensation, and CECL reserves. While the events stemming from COVID-19 are extremely volatile, entities will nevertheless be required to consider conditions as they existed on the balance sheet date when evaluating subsequent events. There are currently many approaches to the consideration of subsequent events in complex estimate analyses such as impairment models (e.g., whether changes in circumstances that alter projection models before issuance date can be considered given the fluidity of the situation).

Although the COVID-19 pandemic and the significant judgment that will most likely need to be applied in assessments related to subsequent event matters, entities are encouraged to consult with their advisers as needed.

Entities should also consider the potential for subsequent-event accounting and reporting associated with the CARES Act's March 27, 2020, enactment. For more information, see Deloitte's *Heads Up*, "Highlights of the CARES Act."

Disclosure Considerations

[Added September 18, 2020]

ASC 855-10-50-2 notes, in part, that "[s]ome nonrecognized subsequent events may be of such a nature that they must be disclosed to keep the financial statements from being misleading." In such circumstances, the disclosures must include (1) the "nature of the event" and (2) an "estimate of its financial effect, or a statement that such an estimate cannot be made."

Income Taxes

Entities should consider how profitability, liquidity, and impairment concerns that could result from the impacts of COVID-19 might also affect their income tax accounting under ASC 740. For example, a reduction in current-period income or the actual incurrence of losses, coupled with a reduction in forecasted income or a forecast of future losses, could result in (1) a reassessment of whether it is more likely than not that some or all of an entity's deferred tax

assets are realizable and (2) a need to recognize a valuation allowance. Such assessments will be particularly challenging in situations in which the changes in current and projected future profitability actually result in or are expected to result in cumulative losses in recent years and the entity has not had a stable earnings history before the impacts of COVID-19. If declining earnings or impairments generate losses, entities will need to consider the character (i.e., capital or operating) of such losses and evaluate whether there is sufficient income of the appropriate character to fully realize the related deferred tax asset.

Adjustments to forecasted income (like those assumed for other impairment analyses) will also need to be factored into an entity's estimated annual effective tax rate (AETR). In some cases, the reduction in forecasted income might be accompanied by a similar reduction in tax (e.g., if the entity has only insignificant permanent items or permanent items that increase or decrease proportionately to ordinary income), resulting in only small changes to the AETR. If, however, an entity's permanent items are more significant and do not "scale," the entity's AETR might be highly sensitive to changes in estimated ordinary income for the year, rendering any individual AETR estimate unreliable. In those instances, the actual effective tax rate for the year to date may be the best estimate of the AETR.

Similarly, if an entity or its subsidiaries have liquidity issues, or other issues resulting from the current economic environment, an entity may also need to reassess whether undistributed earnings of foreign subsidiaries are still indefinitely reinvested or whether a deferred tax liability should now be recorded for an outside basis taxable temporary difference in a foreign subsidiary. While most entities have already recorded U.S. tax on a significant portion of their undistributed foreign earnings and profits,[30] repatriation of such undistributed earnings and profits may still trigger currency gains and losses and be subject to additional withholding or to state or other income taxes.

Entities should account for and disclose changes in tax law (including those related to the CARES Act) in the period that includes the enactment date of such changes. Entities should also be aware that not all forms of tax relief and tax credits will fall within the scope of ASC 740; those that can only be monetized against non-income-based taxes (e.g., payroll taxes) would be accounted for in accordance with other literature. For a complete discussion of the tax effects of the CARES Act, see Deloitte's *Heads Up*, "Highlights of the CARES Act." ***[Paragraph amended April 13, 2020]***

Disclosure Considerations

[Added September 18, 2020]

If a valuation allowance is needed because COVID-19 has affected the realizability of deferred tax assets, entities are encouraged to disclose the types of positive and negative evidence they identified and considered and how they assessed and weighed such evidence in reaching their conclusion. In addition, entities should consider disclosing any changes as a result of (1) determining that their actual effective tax rate for the year to date is their best estimate of the annual effective tax rate and (2) using such amount or modifying any assertions with respect to undistributed foreign earnings and profits.

Internal Control Considerations

Because of the impact of COVID-19, entities may need to implement new internal controls or modify existing ones. Entities must disclose in their quarterly or annual filings any changes in internal controls that have materially affected, or are reasonably likely to materially affect, their internal control over financial reporting (ICFR) in Item 4 of Form 10-Q or in Item 9A of Form 10-K (or in Item 15 of Form 20-F for foreign private issuers).

[30] For example, as a result of the deemed repatriation transition tax in the Tax Cuts and Jobs Act of 2017.

Entities will need to consider the operating effectiveness of controls, including assessing any breakdown in review-type controls or the inability of individuals to perform control duties because of absences (e.g., because of employee illness or the closure of affected locations). Entities should also consider how a lack of information may affect management's ability to effectively operate controls (e.g., personnel may not be available in affected areas to provide information that is essential to the effective operation of an internal control). If an existing control cannot be performed, management may need to identify alternative appropriately designed controls to compensate for the lack of information as well as to potentially identify and evaluate control deficiencies.

Entities should also consider management's ability to complete its financial reporting process and prepare its financial statements on a timely basis. Delays in closing the underlying financial records may increase the potential for error in the financial statements and merit the use of new or modified controls to offset the increased risk of potential financial statement error. In addition, entities will need to ensure that they have properly designed and implemented controls related to the selection and application of GAAP for the accounting and disclosure issues arising from the COVID-19 pandemic. For additional ICFR considerations, see Deloitte's COVID-19 Resources page.

Financial Reporting Under ASC 852 for Entities in Reorganization Under the Bankruptcy Code

If an entity files for bankruptcy under Chapter 11 of the Bankruptcy Code after the balance sheet date but before issuance of the financial statements, the reporting requirements under ASC 852 do not apply. However, the filing itself and pertinent items related to the Chapter 11 filing should be disclosed as required by ASC 855-10-50-2 (see the Subsequent Events discussion for further detail).

Operating During a Chapter 11 Reorganization

The following are some key considerations for entities operating under a Chapter 11 reorganization:

- *Consolidation* — If a subsidiary of a reporting entity files for bankruptcy in the United States under Chapter 11, or seeks similar relief in a foreign jurisdiction (e.g., the Companies' Creditor Arrangement Act in Canada), the reporting entity would need to assess the specific facts and circumstances of that event to determine whether deconsolidating the subsidiary would be appropriate (e.g., deconsolidation may result if the reporting entity does not retain power over the subsidiary's most significant activities during bankruptcy).[31]
- *Cessation of the recognition of interest expense* — In accordance with ASC 852-10-45-11, "[i]nterest expense shall be reported only to the extent that it will be paid during the [bankruptcy] proceeding or that it is probable that it will be an allowed priority, secured, or unsecured claim." The full amount of interest expense based on the contractual rate should be parenthetically disclosed on the face of the income statement or in the footnotes to the extent that the amount is different from that recorded.
- *Classification of current or noncurrent liabilities* — When an entity files for bankruptcy under Chapter 11, all liabilities existing as of the petition date are automatically stayed (cannot be paid) unless payment is approved by the Bankruptcy Court. In accordance with ASC 852-10-45-4 and 45-5, an entity would need to assess such liabilities to determine whether they are expected to be impaired (i.e., creditors are not expected

[31] Reporting entities that apply the equity method to account for investments in common stock or in-substance common stock on the basis of having the ability to exercise significant influence over operating and financial policies of the investee may need to assess the specific facts and circumstances of a bankruptcy by an equity method investee to determine whether they continue to meet the criteria to apply the equity method (e.g., continue to have significant influence over an investee during bankruptcy).

to receive payment in full upon completion of the Chapter 11 proceeding). All such liabilities should be adjusted to their estimated allowed claim amounts and reclassified to a new financial statement line item entitled "liabilities subject to compromise." The new classification would not be considered current or long-term and typically would be presented below noncurrent liabilities.

- *Income statement classification considerations* — If an entity files for bankruptcy under Chapter 11, all income, expense, gain, or loss items directly related to the Chapter 11 proceeding should be separately classified as "reorganization items" in accordance with ASC 852-10-45-9.
- *Debtor-only financial statements* — In accordance with ASC 852-10-45-14, "[c]onsolidated financial statements that include one or more entities in reorganization proceedings and one or more entities not in reorganization proceedings shall include condensed combined financial statements of the entities in reorganization proceedings. The combined financial statements shall be prepared on the same basis as the consolidated financial statements."

Emerging From a Chapter 11 Reorganization

Entities emerging from Chapter 11 must apply the assessment in ASC 852-10-45-19 to determine whether they are required to adopt fresh-start reporting. Key accounting implications for an entity that has adopted fresh-start reporting include:

- *Balance sheet impacts* — In accordance with ASC 805, the reorganization value of the entity must be allocated to the entity's assets and liabilities. ASC 852-10-45-20 states that "[i]f any portion of the reorganization value cannot be attributed to specific tangible or identified intangible assets of the emerging entity, such amounts shall be reported as goodwill in accordance with paragraph 350-20-25-2." In addition, because the implementation of fresh-start reporting results in a new reporting entity, historical equity accounts such as AOCI and retained earnings are adjusted to an opening balance of zero.
- *Four-column footnote* — The entity's footnotes will contain a four-column presentation of the balance sheet as of the effective date of the entity's plan of reorganization, including the historical-basis balance sheet immediately before the effective date of such plan, adjustments to reflect the impacts of the plan, and adjustments to allocate the entity's reorganization value to its identified tangible and intangible assets and liabilities in accordance with ASC 805, resulting in the opening balance sheet of the successor entity.
- *Income statement impacts* — As required by ASC 852-10-45-21, forgiveness of debt, if any, is reported as an extinguishment of debt and classified as a reorganization item. In addition, the effects of the adjustments on the reported amounts of individual assets and liabilities from the adoption of fresh-start reporting must be reflected as a reorganization item. Both the effects of the forgiveness of debt and the remeasurement of assets and liabilities must be reflected in the final income statement of the predecessor entity (the reporting entity ending on the effective date).
- *Segregation of predecessor and successor periods* — As a result of the implementation of fresh-start reporting, the balance sheet and statement of operations of the successor are not comparable to those of the predecessor entity. Accordingly, when comparative periods are presented, a black-line presentation should be used to divide the balance sheet, the statement of operations, and cash flow information between the predecessor and successor periods. Implementation of fresh-start reporting during a fiscal year will result in short-period statements of operations and cash flows for the predecessor and successor. Such a black-line presentation should also be applied to all footnote disclosures of balance sheet, income statement, and cash flow information.

Appendix A — Industry-Specific Insights

Background

Appendix A expands on the content in the body of this Alert by providing industry-specific consideration points. It should not be viewed in isolation; rather, it should be read in conjunction with the body of this Alert.

The appendix discusses key accounting and financial reporting considerations related to the impact of the COVID-19 pandemic on the following industries:

- Banking and Finance
- Media and Entertainment
- Real Estate
- Oil and Gas
- Power, Utilities, and Renewables
- Aerospace and Defense
- Life Sciences
- Consumer
  - Transportation
    - Airlines
    - Shipping and Logistics
    - Passenger Ground Transportation
  - Hospitality and Services
    - Hotels, Resorts, and Casinos
    - Restaurants and Food Services
    - Cruise Lines
  - Retail
  - Automotive

Banking and Finance Industry

Many entities in the banking and finance industry are directly affected by the COVID-19 pandemic, which has already jolted financial markets. Since February 21, 2020, bond yields, oil, and equity prices have decreased sharply across almost all asset classes. In the United States, 10-year bond yields have fallen, as have equity prices on major stock indexes around the world. While such a downturn could have a significant adverse impact on banking and finance companies, current and future announcements of government programs that support banks and their customers will also affect financial results.

While not all-inclusive, the discussion below summarizes some of the more significant financial and reporting considerations for entities within the industry.

Financial Instruments — Impairment and Valuation Considerations

Banking and finance entities are significantly affected by an economic downturn because of the nature of their business activities — such as providing credit through consumer and commercial loans, investing in equity and debt securities, writing guarantees, and entering into derivatives. See the Financial Instruments and Contract Assets discussion for a full description of financial reporting considerations related to the accounting for financial instruments.

Regardless of whether an entity still assesses loans for impairment under the incurred model of ASC 320 or uses the CECL model in ASC 326, an economic downturn will have a significant impact on the allowance for credit losses. However, the economic uncertainty will have more profound effects on companies that are adopting CECL in 2020. The effective date of CECL depends on the nature of the reporting entity.[32]

Once adopted, the new guidance will significantly change the accounting for credit impairment. Although not all-inclusive, the discussion below highlights specific considerations related to CECL.

Estimation of Allowance

Because of the forward-looking nature of ASC 326, macroeconomic forecasting is a significant aspect of estimating expected credit losses. The assumptions used in making such estimates include, but are not limited to, trends in the gross domestic product (GDP), consumer price index, regional or national unemployment rates, and regional or national home price indexes. Once such trends are identified, an entity can develop appropriate forecasts from internal or external sources, or both. During times of economic uncertainty, an entity must identify and evaluate the macroeconomic assumptions it uses in the estimate. Such an evaluation should include consideration of whether the entity's processes, data, and assumptions are responsive to current economic conditions, which may not be the same as those that existed on the date it transitioned to CECL. Examples in which the judgments an entity applied during transition to CECL (e.g., as of January 1, 2020) may need to change on a future date (e.g., March 31, 2020) include the entity's evaluation of the following (see Section 4.3 of Deloitte's *A Roadmap to Accounting for Current Expected Credit Losses* for further discussion of the information set used in a CECL estimate):

- A reasonable and supportable forecast period.
- Segmentation of the portfolio, including an increase in loans that no longer have common credit characteristics.
- The relevant historical loss period to use after reversion.
- New qualitative factors stemming from new or existing limitations in data, models, and assumptions.
- The determination of the industries that are most affected — retail, oil and gas, and hospitality.
- Model performance in adverse economic scenarios that may not have been fully tested.
- Lags or delays in credit risk ratings, which may be exacerbated by the fact that employees are working remotely.
- The impact of running models on a lag basis and whether the lag period is appropriate.

[32] For SEC filers that do not meet the definition of a smaller reporting company (SRC), CECL is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. For all others, CECL is effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. Early adoption for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, is permitted. See Section 9.1.1 of Deloitte's *A Roadmap to Accounting for Current Expected Credit Losses* for the definition of an SEC filer and SRC. Section 4014 of the CARES Act also provides an optional deferral for certain qualifying entities (see Deloitte's *Heads Up*, "Highlights of the CARES Act," for further information). ***[Footnote amended April 13, 2020]***

In addition, an economic downturn can have a significant impact on loan-level factors and estimates, including the expected value of the collateral underlying the lending arrangement. For example, a bank with significant exposure to nonrecourse lending arrangements to the energy sector may have large loan losses because of declines in the fair value of the collateral underlying the lending.

Internal Control

The controls that an entity uses to determine the allowance for credit loss are likely to include management review controls designed to operate in combination with controls over the information that supports the inputs (including the assumptions) upon which the estimate is based. As discussed above, the economic downturn could result in changes in data, models, and assumptions, all of which affect internal controls. For example, an entity may need to implement controls over the relevance and reliability of data from new sources or to validate changes in its models. With employees working remotely, an entity should consider internal controls over how information is shared and how robust discussions occur in management review controls, including the governance over setting the allowance for credit losses. Certain underwriting and credit risk monitoring control activities, such as inventory observations and appraisals for collateralized borrowings, are generally done on site; thus, they could be disrupted by COVID-19 precautions.

Transition Adjustment

As discussed above, calendar-year public business entities that are SEC filers, except for SRCs, adopted CECL on January 1, 2020. Some have questioned whether any of the estimated impacts of COVID-19 that are calculated during the first quarter of 2020 could be "pushed back" into the transition adjustment as of January 1, 2020. Although COVID-19 was identified as of January 1, 2020, we generally do not believe that the recent events (e.g., failure of containment, subsequent spread, declaration of a global pandemic, and the severe impact on global economics) were known or knowable as of the CECL transition date. Therefore, it would not be appropriate to use hindsight in determining the CECL transition adjustment. Rather, the impact on the CECL estimate, if any, related to the more recent COVID-19 developments after the transition date should be considered in the first quarter of adoption, with any change in the estimate from COVID-19 affecting the income statement.

Loan Commitments

Off-balance-sheet arrangements, such as commitments to extend credit, guarantees, and standby letters of credit, are subject to credit risk; therefore, arrangements that are not considered derivatives under ASC 815 are within the scope of the CECL model. Accordingly, under ASC 326, an entity's method for determining the estimate of expected credit losses on the funded portion of a loan commitment must be similar to its method for determining the estimate for other loans. For an unfunded portion of a loan commitment, an entity must estimate expected credit losses over the full contractual period over which it is exposed to credit risk under an unconditional present legal obligation to extend credit. Such an estimate takes into account both the likelihood that funding will occur and the expected credit losses on commitments to be funded.

Many commercial banks have large portfolios of off-balance-sheet lending commitments, which are in the scope of the CECL standard. Historically, funding of loans under these lending facilities may have been low for certain industries or portfolios because of strong macroeconomic performance and the borrowers' lack of liquidity needs. Banks generally use these historical funding levels to develop their expectations of future funding. Therefore, banking and finance entities will need to carefully evaluate their assumptions about funding given the likelihood that recent events will cause borrowers to have greater needs for liquidity. See Chapter 5 of Deloitte's *A Roadmap to Accounting for Current Expected Credit Losses* for further information on accounting for loan commitments under CECL.

Subsequent Events

Economic uncertainty may continue to evolve for the foreseeable future. When estimating an allowance for credit loss related to on- and off-balance-sheet exposures, banking and finance entities must consider the impact of subsequent events that occur after the end of a reporting period. For example, certain macroeconomic factors (e.g., unemployment) will not be available on March 31, 2020; instead, the data will typically be reported in April. In a December 10, 2018, speech, the SEC staff addressed the consideration of subsequent events in various scenarios and generally indicated that it would not object to the inclusion (or omission) of information that extends beyond the balance sheet date as long as it is not loan-specific (e.g., unemployment or other macroeconomic factors). However, if the information is

loan-specific and is about factual conditions that existed as of the balance sheet date (e.g., a loan servicer or appraisal report), the entity must consider the information as of the balance sheet date even if it was received after the end of the reporting period. See Section 4.8 of Deloitte's *A Roadmap to Accounting for Current Expected Credit Losses* for further information.

Goodwill

The economic downturn has unique and challenging implications for banking and finance entities, including financial exposure to (1) consumer borrowers who may become unemployed or underemployed as a result of any governmental measures to curb the spread of the virus and (2) borrowers in industries that are affected by the downturn. In addition, a tightening of credit markets and a decrease in interest rates may compress projected profitability. Given the sudden decrease in the market value of many public banks in the first quarter of 2020 and the uncertain economic forecast, entities may need to test goodwill for impairment. For further discussion, see the Goodwill section.

Troubled Debt Restructurings

[Section amended April 13, 2020]

Banking and finance companies often modify the payment terms of a loan when the borrower is experiencing financial difficulties and will be unable to make payments under the contract. ASC 310-40 establishes the accounting and reporting requirements for a TDR, which occurs when (1) the debtor is experiencing financial difficulties and (2) the creditor grants a concession to the terms of the lending arrangement. A concession can take many forms, which range from extending payment terms to reducing required payments. However, a restructuring that results in only an insignificant delay in payment is not considered a concession for purposes of determining whether a TDR has occurred. In accordance with ASC 310-40-15-17, an entity should consider the following factors together when evaluating whether a delay in payment is insignificant:

a. The amount of the restructured payments subject to the delay is insignificant relative to the unpaid principal or collateral value of the debt and will result in an insignificant shortfall in the contractual amount due.

b. The delay in timing of the restructured payment period is insignificant relative to any one of the following:

   1. The frequency of payments due under the debt
   2. The debt's original contractual maturity
   3. The debt's original expected duration.

For an entity that has not yet adopted ASC 326, a loan restructured in a TDR is an impaired loan. To calculate the impairment, the entity would perform a discounted cash flow analysis of the loan by using the effective interest rate of the loan before the modification as the discount rate. This analysis essentially requires the lender to recognize a loss for the adverse change in cash flows resulting from the modification (in both amount and timing).

For an entity that has adopted ASC 326, the allowance for credit losses should factor in the effects of a TDR when a TDR is reasonably expected at the individual loan level. In addition, the contractual life of a loan should take into account any extensions resulting from the reasonably expected TDR.

Regardless of whether ASC 326 has been adopted, an entity must comply with ongoing disclosure requirements related to a loan restructured through a TDR over the remaining life of the restructured loan.

Banking and finance companies may modify the terms of loans because of the impact of the pandemic on the borrowers' financial resources. In fact, banking and finance companies may roll out large-scale relief programs, potentially even in response to mandates from governmental authorities. Some of these programs may even be offered to borrowers that are current on their payments.

On March 22, 2020, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the National Credit Union Administration, the Conference of State Bank Supervisors, and the Consumer Financial Protection Bureau issued the ***Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working With Customers Affected by the Coronavirus*** (the "Interagency Statement") to encourage financial institutions to work constructively with borrowers affected by COVID-19 and provide additional information regarding loan modifications. The Interagency Statement states that the "agencies have confirmed with [the FASB staff] that short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief, are not TDRs. This includes short-term (e.g., six months) modifications such as payment deferrals, fee waivers, extensions of repayment terms, or other delays in payment that are insignificant. Borrowers considered current are those that are less than 30 days past due on their contractual payments at the time a modification program is implemented" (footnote omitted).

In addition, the Interagency Statement states that "[m]odification or deferral programs mandated by the federal or a state government related to COVID-19 would not be in the scope of ASC 310-40, e.g., a state program that requires all institutions within that state to suspend mortgage payments for a specified period."

On March 22, 2020, the FASB also issued a statement, in which the Board acknowledged the Interagency Statement and confirmed that the "guidance [in the Interagency Statement] was developed in consultation with the staff of the FASB who concur with this approach and stand ready to assist stakeholders with any questions they may have during this time."

Section 4013 of the CARES Act provides temporary relief from the accounting and reporting requirements for TDRs associated with certain loan modifications related to COVID-19 that are offered by "financial institutions, including insurance companies."[33] Specifically, a financial institution may elect to suspend (1) the requirements under U.S. GAAP for certain loan modifications that would otherwise be categorized as a TDR and (2) any determination that such loan modifications would be considered a TDR, including the related impairment for accounting purposes. The modifications that would qualify for this exception include any modification involving a loan that was not more than 30 days past due as of December 31, 2019, and that occurs during the "applicable period,"[34] including any of the following:

- A forbearance arrangement.
- An interest rate modification.
- A repayment plan.
- Any other similar arrangement that defers or delays the payment of principal or interest.

The relief does not apply to any adverse impact on the credit of a borrower that is not related to the COVID-19 pandemic.

The CARES Act and the interagency statement overlap in many areas, but they are not consistent. For example, the interagency statement requires an entity to evaluate whether the borrower is less than 30 days past due at the time a modification program is implemented, while under the CARES Act, that determination is made as of December 31, 2019. In addition, the CARES Act allows interest rate modifications to occur on the loans, whereas the interagency statement only provides relief for modifications associated with the timing of payments (e.g., deferrals).

[33] The relief provided by the CARES Act related to TDRs was extended by the Consolidated Appropriations Act, 2021 (CAA), which was signed into law on December 27, 2020. Section 541 of Division N of the CAA clarifies that insurance companies are financial institutions for CARES Act Section 4013 purposes. A financial institution or an insurance company is not a defined term under the CARES Act, the CAA, or U.S. GAAP. Entities may need to consult with legal counsel for assistance in determining whether they are eligible to apply Section 4013 of the CARES Act. ***[Footnote and associated text amended January 11, 2021]***

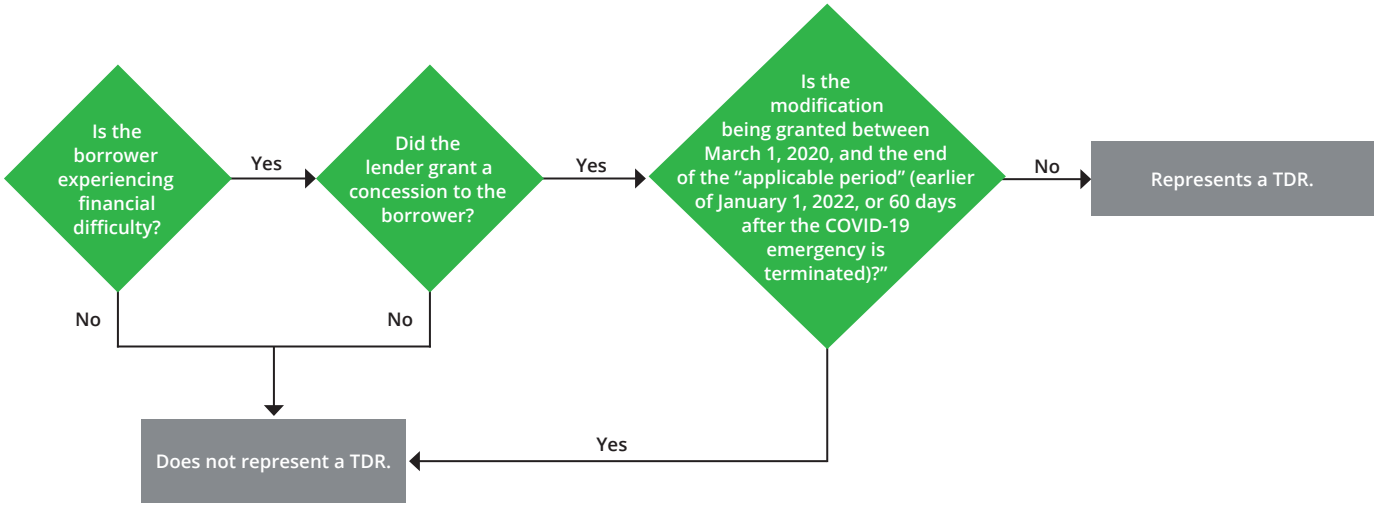
[34] The applicable period for loan modifications means the period beginning on March 1, 2020, and ending on the earlier of (1) January 1, 2022, or (2) the date that is 60 days after the termination date of the national emergency declared by President Trump under the National Emergencies Act on March 13, 2020, related to the outbreak of COVID-19. ***[Footnote amended January 11, 2021]***

In his April 3, 2020, statement on actions the SEC has been taking in response to COVID-19, SEC Chief Accountant Sagar Teotia indicated that for those financial institutions that are eligible to apply the provision of the CARES Act related to the modification of loans, an election to apply that provision would be in accordance with GAAP.

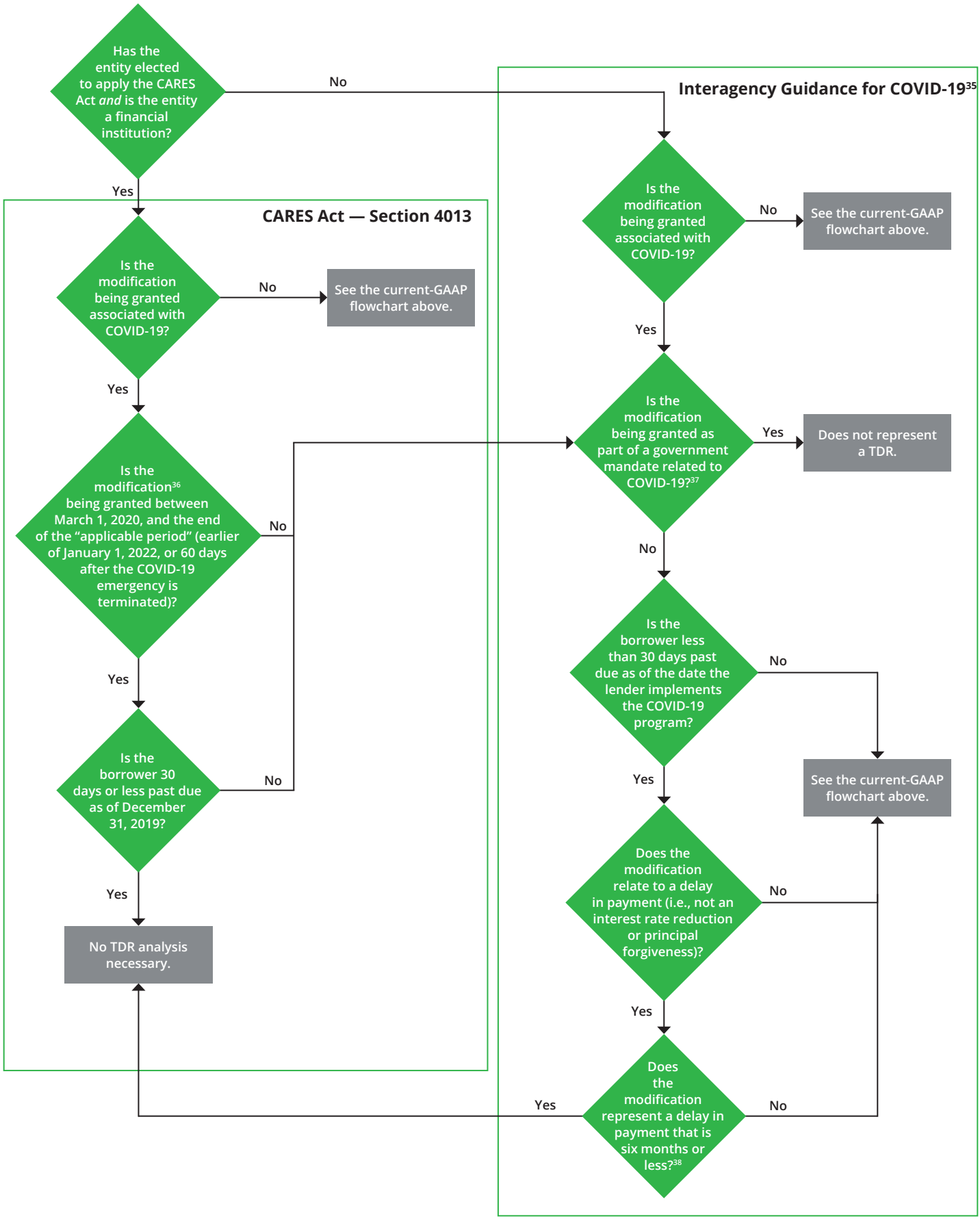
In addition, the SEC staff continues to collaborate with the FASB staff, the AICPA, banking regulators, and other stakeholders on some of the related implementation questions, including the relationship between the CARES Act and the interagency statement. Regarding that relationship, the banking agencies issued on April 7, 2020, a revised interagency statement to clarify the interaction between the March 22, 2020, interagency statement and Section 4013 of the CARES Act. According to the revised interagency statement, financial institutions may account for eligible loan modifications under Section 4013 of the CARES Act, and any loan modification that does not meet the conditions in that section may still qualify as a modification that does not need to be accounted for as a TDR. The agenda for the FASB's April 8, 2020, meeting notes that the Board "will help its stakeholders interpret guidance related to priority issues, including troubled debt restructurings and lease modifications." However, the Board did not discuss TDRs at that meeting.

Entities may find the following flowchart (which reflects the above announcements and guidance provided to date) to be helpful as they navigate the scope of modifications as TDRs:

Current GAAP — ASC 310-40



The guidance in the flowchart below only applies during the COVID-19 pandemic and cannot be applied to modification programs unrelated to COVID-19 in the future.



[35] Although the interagency guidance applies to financial institutions regulated by the agencies that issued it, because the guidance was developed in consultation with the FASB staff, which concurred with the approach, we believe that nonfinancial institutions may also elect to apply the guidance.

[36] Under the CARES Act, a modification may include a forbearance arrangement, an interest rate modification, a repayment plan, and any other similar arrangement that defers or delays the payment of principal or interest.

[37] This would apply only if the lender had no option to avoid granting the modification.

[38] We believe that two three-month consecutive delays, for example, could be acceptable.

For more information on applying the CARES Act and interagency guidance to a modification, see Deloitte's *Heads Up*, "Frequently Asked Questions About Troubled Debt Restructurings Under the CARES Act and Interagency Statement."

Entities that apply the TDR guidance discussed in Section 4013 of the CARES Act or the revised interagency statement will need to consider providing relevant disclosures in the notes to the financial statements and, for SEC registrants, in MD&A. On the basis of informal discussions, we understand that the SEC's Division of Corporation Finance believes that many of the suggested disclosures on loan modifications that were discussed in a speech made in December 2010 would be relevant disclosures for loan modifications related to COVID-19.

Interest Income During Payment Holidays

[Section added April 13, 2020]

At the FASB's April 8, 2020, meeting, the FASB staff discussed a technical inquiry regarding the recognition of interest income by an institution that was assisting borrowers affected by COVID-19. The institution provided a "loan payment holiday," during which borrowers could temporarily stop payments and interest would not legally accrue. The loan modification did not represent a TDR, nor would it be accounted for as an extinguishment of the original loan and the recognition of a new loan.

Two views were expressed related to the technical inquiry:

- *View 1* — "Upon modification, a new effective interest rate in accordance with Subtopic 310-20 is determined that equates the revised remaining cash flows to the carrying amount of the original debt and is applied prospectively for the remaining term. That is, interest income is recognized during the payment holiday period."
- *View 2* — "Upon modification, the institution should recognize interest income on the loan in accordance with the contractual terms. Under this view, the institution would recognize no interest income during the payment holiday and would resume recognizing interest income when the payment holiday ends."

The FASB staff noted that it believed that both views were acceptable.

Media and Entertainment Industry

Many entities in the media and entertainment industry are directly affected by COVID-19. While not all-inclusive, the discussion below summarizes some of the more significant considerations for entities within the industry.

Live Events

Revenue Recognition

Many sports and entertainment entities have cancelled or postponed live events. These entities will need to consider a number of potential implications, including whether refund provisions exist or whether they need to provide other concessions for previously sold tickets, sponsorships, venue rentals, etc. Such provisions may affect revenue recognition in the period.

In addition, many sports and entertainment entities license the exhibition rights of live events to media broadcasters and similar entities. For example, a regional sports network may have the exhibition rights to broadcast the games of a professional sports team in a certain market. In this case, both the licensor (e.g., the professional sports team) and the licensee (e.g., media broadcaster) would need to carefully consider the payment terms under the license agreement and whether such payments would continue or need to be refunded under a "stoppage of play" scenario. For the licensor, this may affect the timing and amount of revenue recognition under the license agreement. The licensee should consider whether it needs to update the amount and pattern by which it recognizes license payments over the license term. Further, the licensee may have contractual agreements with distribution partners in which it receives consideration in exchange for delivering a certain number of the live sporting events. In such circumstances, entities should apply similar considerations to those related to the stoppage of play scenario.

Media companies will also need to consider any previously sold advertising time during live event broadcasts. Such sales agreements may include audience ratings or impression guarantees that may not be met in the absence of the live event (e.g., if the game or match is not played). In such instances, entities will need to consider (1) the timing and pattern of revenue recognition and (2) whether they need to establish a refund liability.

For further discussion, see the Revenue Contracts With Customers section.

Production Costs

Entities may have previously incurred production costs in connection with an upcoming event. If these costs have been capitalized, entities will need to determine whether such costs are recoverable or should be written off in the period. In addition, entities should carefully consider whether such production costs are subject to insurance coverage and, if so, determine when to recognize the proceeds. For further discussion, see the Insurance Recoveries section.

Film Ultimates and Impairment

Film studios are also experiencing weaker than expected box office performance because of theater closures in response to the pandemic, which may affect the expected ultimate revenues over the life of a film. ASC 926-20-35-3 requires entities to "review and revise estimates of ultimate revenue as of each reporting date to reflect the most current available information." Accordingly, film studios should carefully consider the impact of recent events and whether they need to revise their estimates of ultimate revenue.

Many studios have also announced delays in the theatrical releases of movies or have currently halted production. Under ASC 926-20-35-12, 35-12A,[39] and 35-12B,[40] entities must test unamortized film costs for impairment whenever events or facts and circumstances suggest that the fair value of a film (film group) may be less than its unamortized cost. While not all inclusive, the following examples listed in ASC 926-20-35-12A are indicators that an impairment test should be performed for a film.

a. An adverse change in the expected performance of a film prior to [its] release

b. Actual costs substantially in excess of budgeted costs

[39] For entities that have adopted FASB Accounting Standards Update No. 2019-02, *Improvements to Accounting for Costs of Films and License Agreements for Program Materials*.

[40] See footnote 32.

c. Substantial delays in completion or release schedules

d. Changes in release plans, such as a reduction in the initial release pattern

e. Insufficient funding or resources to complete the film and to market it effectively

f. Actual performance subsequent to release failing to meet expectations set before release due to factors such as the following:

   1. A significant adverse change in technological, regulatory, legal, economic, or social factors that could affect the public's perception of a film or the availability of a film for future showings

   2. A significant decrease in the amount of ultimate revenue expected to be recognized

g. A change in the predominant monetization strategy of a film resulting in the film being predominantly monetized with other films and/or license agreements.

While not all inclusive, the indicators in ASC 926-20-35-12B provide examples of circumstances in which an impairment test should be performed for a film group:

a. A significant adverse change in technological, regulatory, legal, economic, or social factors that could affect the fair value of the film group

b. A significant decrease in the number of subscribers or forecasted subscribers, or the loss of a major distributor

c. A current-period operating or cash flow loss combined with a history of operating or cash flow losses or a projection of continuing losses associated with the use or exploitation of a film group.

Accordingly, entities will need to carefully evaluate the impact of recent events to determine whether a film (film group) may be impaired. For instance, they should consider whether a decision to delay the release of a film is solely a result of COVID-19 uncertainty or whether there are other underlying concerns regarding the film's expected performance.

Real Estate Industry

The real estate industry may be affected by the potential impacts of COVID-19, which include an increase in telecommuting, social distancing, temporary business closures, school closures, event cancellations, changes in shopping patterns, and disruptions in talent and workforce models. The effect on each subsector of the real estate industry and on each geographic location may be different. As the events and conditions related to COVID-19 evolve, it will be important for entities in the real estate industry to monitor and evaluate their accounting- and disclosure-related responses.

While not all-inclusive, the discussion below highlights some of the more significant financial and reporting considerations for entities in the real estate industry.

Impairment of Long-Lived Assets, Including Real Estate Assets

Real estate entities should evaluate and consider the impacts of COVID-19, including any tenant-related changes or disruptions, and determine whether there are any new indicators of impairment. See the Long-Lived Assets discussion for further information.

Rent Relief and Other Support for Tenants

[Section amended April 13, 2020]

As a result of the pandemic, lessors could be asked or have obligations to provide rent rebates or other rent relief (such as a temporary decrease in rent or a change to variable lease payments that depend on sales). In these cases, lessors should consider the FASB's relief that applies when certain circumstances related to COVID-19 are met (i.e., the cash flows are substantially the same or lower), which permits them to treat the concession as a modification or not a modification without performing an evaluation on a contract-by-contract basis. See the Lease/Rent Concessions discussion for further information.

Disclosure Considerations

Real estate entities should provide disclosures about the impacts of the pandemic consistently throughout all their SEC filings (including Forms 10-K, 10-Q, and 8-K, and registration statements). Similarly, such disclosures should also be provided consistently within a specific filing. For example, the Risk Factors section should cover specific risks related to pandemics and the related impact from actions such as office closures, event cancellations, social distancing, and changes in the workforce model. The Business and MD&A sections should include any effects on operational metrics (such as occupancy changes), liquidity, lease collectibility, and any early-warning disclosures of upcoming impairments, including disclosures of any impairment triggers. Given the pervasive use of joint venture and equity method investment structures in the industry, real estate entities may also need to consider whether they will be able to obtain sufficient information and audited financial statements from their equity method investees to comply with their SEC Regulation S-X requirements (specifically, Rules 3-09, 4-08(g), and 10-01(b)(1)). See the SEC Reporting and Disclosure Considerations discussion for further information, including the use of non-GAAP measures.

Oil and Gas Industry

Early in 2020, oil prices began a steady decline, driven partially by the impacts of the COVID-19 outbreak on the worldwide economy. Oversupply and declining demand have led to the erosion of more than 50 percent of the value of crude oil since December 31, 2019, and the benchmark U.S. oil price has fallen to below $30 a barrel. Oil futures have also declined in a similar fashion. The lower oil prices may reduce the viability of drilling since the cost of extracting the oil or natural gas may exceed the revenue generated (e.g., it may not be profitable to drill in certain areas).

As entities in the upstream sector curtail the number of drilling rigs that they are actively running in their programs, they may seek cost reductions from service providers, including those in the midstream and oil field services sector. This will result in a slowdown in services provided by midstream entities as a result of fewer actively working rigs in 2020 and, therefore, fewer wells to be completed and brought online.

Accordingly, upstream entities will need to consider their particular facts and circumstances, including any potential early-warning signs of negative revisions of proved reserves as well as the related impairment implications, when performing their impairment assessments.

Upstream Impairment Considerations — Successful-Efforts Method

Entities that use the successful-efforts method apply the guidance in ASC 932-360-35 and ASC 360-10-35 to account for the impairment of their oil and gas (O&G) assets. Under the successful-efforts method, a company generally performs a traditional two-step impairment analysis in accordance with ASC 360 whenever an event or change in circumstance indicates that the asset group's carrying amount may not be recoverable.

Upstream Impairment Considerations — Full-Cost Method

Exploration and production companies that use the full-cost method of accounting should apply the guidance in SEC Regulation S-X, Rule 4-10, SAB Topic 12.D,[41] and FRC Section 406.01.c[42] to assess whether O&G assets are impaired.

Under the full-cost method, a full-cost ceiling test must be performed on proved properties in each reporting period. The evaluation is prescribed and is not reflective of fair value. The primary differences between the full-cost ceiling test and an evaluation performed under the successful-efforts method are as follows:

- Commodity pricing is based on the historical 12-month weighted average price rather than on future commodity pricing.
- Companies discount cash flows at 10 percent rather than perform a two-step process under which the discount in step 1 is zero and market-based in step 2.

The full-cost accounting approach requires a write-down of the full-cost asset pool when net unamortized cost less related deferred income taxes exceeds (1) the discounted cash flows from proved properties (i.e., estimated future net revenues less estimated future expenditures to develop and produce proved reserves), (2) the cost of unproved properties not included in the costs being amortized, and (3) the cost of unproved properties included in the costs being amortized. The write-down would be reduced by the income tax effects related to the difference between the book basis and the tax basis of the properties involved.

Midstream and Oil Field Service Company Impairment Considerations

Midstream and oil field service companies will need to consider how a reduction in upstream activity may affect their operations and associated accounting. For example, considerations may include the impairment of long-lived assets under ASC 360, the impairment of goodwill under ASC 350, and liquidity.

[41] SEC Staff Accounting Bulletin Topic 12.D, "Application of Full Cost Method of Accounting."
[42] SEC Codification of Financial Reporting Policies, Section 406.01.c, "Full Cost Method."

Power, Utilities, and Renewables Industry

The impacts of COVID-19 on the power, utilities, and renewables (PU&R) industry continue to evolve. The magnitude of the effects will most likely depend largely on the level of the supply chain disruption and the economic downturn in affected regions. Entities will need to carefully consider any governmental policy directives in response to the pandemic. In certain markets, governments may attempt to provide financial relief to citizens through measures that could include reducing utility bills; such directives may directly affect local utility providers. The COVID-19 pandemic is expected to affect both regulated and unregulated operations.

Two impacts of the pandemic that could affect financial reporting for entities in the PU&R industry are discussed below. For more information, see Deloitte's *COVID-19 Accounting and Reporting Considerations for Power, Utilities, and Renewables*.

Impact of Supply Chain Disruption on Construction Timelines

Construction timelines in the renewable energy sector are under pressure because of supply chain disruptions in China and elsewhere. Foreign markets produce many of the components used in the solar industry, in particular. Such disruptions could affect both residential applications and large-scale projects. In some cases, these disruptions could jeopardize a developer's ability to complete construction in time to qualify for federal tax credits. Often, the tax credits are necessary to make the project economically viable, and some developers will have to face difficult decisions about completing construction or abandoning the project. In other cases, development pipelines will be affected by the scarcity of available financing. In the United States, failure to obtain financing and begin construction by the end of 2020 will jeopardize a project's eligibility for tax credits unless the federal government extends the deadline or offers targeted relief to lessen the impact of COVID-19. Affected entities should consider the financial reporting implications, including asset impairment and impairment of capitalized development costs. There may also be disclosure considerations, including concentration risk with respect to supply chain issues and the risk associated with meeting the tax credit deadlines.

Impact of Government Policy Initiatives on Customer Billing Practices

Customer accounts receivable are generally reported net of a provision for uncollectible accounts. Certain segments of a utility customer base may experience employment layoffs or other displacements related to COVID-19, which may negatively affect the customers' ability to pay utility bills on a timely basis. This could result in a short-term phenomenon of "slow-pays and no-pays" as customers react to the current environment. In addition, some utilities have volunteered to cease all service shutoffs for nonpayments for a specified period, and some entities may ultimately be subject to other types of payment abatement programs imposed by regulators or governments. As a result, it will be important for utilities to carefully consider what credit losses to expect in the current environment. When evaluating the payments it expects to receive from customers, an entity should consider issues associated with a customers' ability to pay as well as the entity's payment accommodations. For some utilities, any incremental bad debt expenses that arise from the current circumstances may be recoverable in future rates; in such cases, the entity should consider whether a regulatory asset should be recorded for these costs.

Aerospace and Defense Industry

The impacts of COVID-19 on the aerospace and defense industry are quickly evolving and may be extensive for the commercial portion of the industry. Among the many impacts are restrictions on travel, reduced customer liquidity, and supply chain disruption. The magnitude of the effects on aerospace and defense entities will vary depending on a particular entity's mix of commercial and defense customers, the products the entity manufactures, and the entity's location. Such entities will also need to consider the impacts of any government assistance that may be provided.

Other key considerations for aerospace and defense entities are discussed below.

Inventory

Entities may experience changes in production levels because of temporary shutdowns, a reduction in the number of production shifts, or both. Entities will need to use judgment in determining what constitutes abnormal production levels in their circumstances. ASC 330-10-30-4 states that the "range of normal capacity will vary based on business- and industry-specific factors. Judgment is required to determine when a production level is abnormally low (that is, outside the range of expected variation in production)."

Accounting for Estimates of Contract Costs and Variable Consideration

An entity may need to reevaluate the expected costs of completing its contracts and consider the estimated impact of the costs of future material, labor costs, and the allocation of overhead rates given the availability of resources and the supply chain. In addition, entities will need to exercise judgment in evaluating whether changes in costs affect the measure of progress. Assumptions used to estimate variable consideration may also need to be updated on the basis of current circumstances. Further, an entity that has construction- and production-type contracts within the scope of ASC 605-35 may also need to consider whether a change in its estimated costs would result in a contract loss that would need to be recognized immediately.

Contract Assets and Accounts Receivable

Entities may need to evaluate the recoverability of existing contract assets and accounts receivables on the basis of updates to future cost and revenue estimates for individual contracts, customer behavior, and individual circumstances and modifications.

Delays in Government Funding

Contracts may be funded annually or at more frequent intervals. Entities may need to consider whether delays in government contracting may increase the risk of unfunded inventory levels, which may affect revenue recognition.

Life Sciences Industry

Many entities in the life sciences industry are directly affected by COVID-19. The Food and Drug Administration (FDA) has acknowledged potential disruption to the industry as a result of the COVID-19 pandemic. In March 2020, the FDA published guidance on the significant disruption to the conduct of clinical trials, which states, in part:

> FDA recognizes that the COVID-19 pandemic may impact the conduct of clinical trials of medical products. Challenges may arise, for example, from quarantines, site closures, travel limitations, interruptions to the supply chain for the investigational product[3] or other considerations if site personnel or trial subjects become infected with COVID-19. These challenges may lead to difficulties in meeting protocol-specified procedures, including administering or using the investigational product or adhering to protocol-mandated visits and laboratory/diagnostic testing. FDA recognizes that protocol modifications may be required, and that there may be unavoidable protocol deviations due to COVID-19 illness and/or COVID-19 control measures.

[3] For the purposes of this guidance, the term *investigational product* refers to human drugs and biological products, and medical devices.

While not all-inclusive, the discussion below summarizes some of the unique considerations for entities in the industry.

Failure-to-Supply Penalties in Sales Contracts May Increase

Some contracts with customers include a clause requiring the entity to pay a penalty to the customer if it is unable to fulfill an order on a timely basis or to meet certain performance conditions specified in the contract. Life sciences entities may be more likely to incur penalties as a result of supply chain disruption because of the concentration of active pharmaceutical ingredient (API) manufacturing in China. As illustrated in ASC 606-10-55-194, Example 20, an entity should consider such penalties to be variable consideration in estimating the transaction price with the customer. Furthermore, and as discussed in the Contractual Penalties section, the obligation to pay a penalty under such a scenario, once triggered, does not represent a contingent loss under ASC 450-20; rather, the obligation should be accounted for as a contractual liability. The probability of payment is irrelevant if settlement of the liability is required by law or by contract. That is, other than deferred revenues, liabilities established by law or contract should be recorded at their stated amounts unless the guidance in U.S. GAAP requires otherwise. An entity's uncertainty about whether an obligee will require performance does not (1) allow the entity to choose to avoid the future sacrifice or (2) relieve the entity of the obligation. Once recognized, a contractual or legal liability that is not deferred revenue (i.e., a contract liability under ASC 606) should be derecognized only when the conditions for liability derecognition in ASC 405-20-40-1 have been met (i.e., relief through repayment, or through a legal release either judicially or by the creditor).

Retroactive Payback Provisions May Require Reestimation

In certain countries, companies are required to pay rebates to the country's government health care system if domestic industry sales exceed specified thresholds in a given year. In such a case, the portion of the payback allocated to an individual company is based on that company's current market share (or sales) in relation to the industry as a whole. For revenue recognition purposes, a retroactive payback provision represents variable consideration that would need to be estimated, subject to the variable consideration constraint. Given the significant health care costs being incurred in many jurisdictions with such provisions, the likelihood that domestic industry sales will exceed specified thresholds may be higher than initially estimated. In addition, a life sciences entity's market share could be negatively affected by supply chain disruption as a result of the COVID-19 pandemic. Therefore, an entity may need to consider revising its estimates of such provisions.

Delays in FDA Approvals Could Have Accounting Implications for Indefinite-Lived IPR&D Assets and Contingent Consideration Liabilities

In a March 10, 2020, statement, FDA Commissioner Dr. Stephen Hahn noted:

> After careful consideration, the FDA is postponing most foreign inspections through April, effective immediately. Inspections outside the U.S. deemed mission-critical will still be considered on a case-by-case basis. . . . We are aware of how this action may impact other FDA responsibilities, including product application reviews. We will be vigilant and monitor the situation very closely and will try to mitigate potential impacts from this outbreak in lockstep with the whole of the federal government. We stand ready to resume foreign inspections as soon as feasible.

Under ASC 350-30-35-18, an "intangible asset that is not subject to amortization shall 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 delay in product application reviews could represent a qualitative indicator that the value of capitalized in-process research and development (IPR&D) is impaired, thus necessitating an impairment test. Furthermore, additional uncertainty in regulatory approval caused by a delay in product application reviews could affect the estimate of contingent consideration liabilities that have been recorded in connection with either a previous asset acquisition or business combination if such contingent payments are related to regulatory approval and commercialization milestones.

Potential Impact on Contract Research and Development Arrangements

Life sciences entities that have contractual arrangements to perform contract research and development (R&D) for others (e.g., biotechs and contract research organizations) may experience a significant increase in the cost of performing contract R&D (e.g., the inability of an entity's personnel to perform monitoring visits or to enroll patients in clinical trials), which could have revenue recognition implications. For example, an entity that uses a cost-based input method to measure its progress toward complete satisfaction of a performance obligation would need to reevaluate whether its measure of progress is affected by a significant increase in the overall cost of the R&D program or whether such increased costs should be excluded from the measure of progress because they do not depict the entity's performance in transferring control of the contract R&D (e.g., if the costs are due to unexpected amounts of wasted materials, labor, or other resources). Furthermore, the potential disruption in an entity's performance of contract R&D could affect its estimate of variable consideration in circumstances in which the entity is entitled to receive R&D milestone payments if (1) clinical trial regulatory approvals are received by a certain date or (2) regulatory approval for commercialization is ultimately achieved, or (3) both.

Consumer Industry

Transportation, Hospitality, and Services

The transportation, hospitality, and services industry has suffered amid the COVID-19 pandemic and faces operating cost, cash flow, and liquidity pressures that are likely to affect 2020 results and future forecasts. Revenues of airlines, cruise lines, and other transportation companies, along with those of hospitality and service companies (including hotels and resorts, casinos, restaurants, and food services companies), are expected to be considerably reduced in 2020.

Transportation Sector

Airlines

Some consider airlines to be at the epicenter of the COVID-19 pandemic. Airlines are facing rapidly changing operating and financial challenges because of governmental and business travel restrictions and declining consumer and business demand for air travel. Several major airlines have indicated a reduction in flight operations and schedules. While increased sanitation expenses may be offset by lower oil prices, which may have a positive impact on airline fuel costs, the potential for significant reduction of flight operations, idling of aircraft, and reduction in airline staffing remains a risk. The major airlines are currently evaluating the adequacy of cash positions, access to liquidity, and prolonged reductions in demand and revenue, all of which could materially affect airline operations.

Noteworthy accounting considerations include:

- Impairment of long-lived assets (e.g., aircraft, goodwill and other intangibles) due to reductions in aircraft utilization, idling of aircraft, and profitability challenges.
- Liquidity, covenant compliance, and going-concern considerations resulting from potentially prolonged declines in revenue and demand.
- Restructuring costs related to potential staff reductions due to reductions in flight demand.
- Evaluation of key assumptions for estimating the customer loyalty program obligations since prolonged reductions in demand can affect such assumptions (e.g., estimated breakage of loyalty points). Changes to customer loyalty programs in light of current conditions, such as an entity's decision to voluntarily extend expiration terms, should be monitored and evaluated; these changes may result in more frequent revisions to breakage assumptions and estimates.
- Evaluation of impacts on revenue recognition related to changes in airline cancellation and change fee policies.

Shipping and Logistics

Shipping and logistics businesses tend to be cyclical and generally are directly affected by product supply and demand. These businesses can also be affected by staff illnesses or absences, which could delay product delivery. As a result of potential workforce shortages and other supply chain issues (e.g., reductions in product availability), shipping and logistics companies may face challenges in managing the timely delivery of products in periods of high demand.

Noteworthy accounting considerations include:

- Liquidity, covenant compliance, and going-concern considerations to the extent that volume and revenue decline as a result of either reduced product demand or a workforce shortage.
- Impairment of long-lived assets, particularly vessels (since entities may need to sell or scrap vessels to maintain liquidity).
- Evaluation of the timing of revenue recognition since product delays, crewing issues, or delays at ports may require reevaluation of the voyage time (which affects revenue recognition).
- Evaluation of accounts receivable for collectibility.

Passenger Ground Transportation

Passenger ground transportation businesses, including public and private modes of transportation, are being affected by COVID-19 as governments and businesses are curtailing travel and encouraging employees to work from home. Typically, passenger ground transportation businesses benefit from the volume of deplanements. However, airlines have experienced recent declines and planned reductions, which have translated into lower demand for passenger ground transportation services.

Noteworthy accounting considerations include:

- Liquidity, covenant compliance, and going-concern considerations resulting from potentially prolonged declines in revenue due to reductions in travel, the inability to modify fleet purchase commitments, and the adverse effect of the pandemic on the timing of fleet sales.
- Impairment of long-lived assets, including goodwill and other intangibles. In particular, when considering impairment of long-lived assets, an entity may need to reconsider fleet residual values.
- Evaluation of key assumptions for estimating the customer loyalty program obligations since prolonged reductions in demand can affect such assumptions (e.g., estimated breakage of loyalty points). Changes to customer loyalty programs in light of current conditions, such as an entity's decision to voluntarily extend expiration terms, should be monitored and evaluated; these changes may result in more frequent revisions to breakage assumptions and estimates.

Hospitality and Services Sector

Hotels, Resorts, and Casinos

Hotel, resorts, and casino businesses are experiencing the impacts of COVID-19 as room rates, occupancy levels, and overall resort property revenues decline as a result of reduced demand associated with restrictions on travel and social gatherings. Hotels and integrated resorts, including resorts with casino, entertainment, convention, retail, food and beverage, and ancillary revenue operations, are experiencing business challenges in the face of declining consumer demand and both mandatory and voluntary property closures.

Noteworthy accounting and internal control considerations include:

- Evaluation of revenue recognition related to changes in cancellation policies, SSPs for complimentary rooms, and management company agreements that include incentive fees and the achievability of those targets.
- The likelihood that entities will experience postponements or full cancellations of individual leisure travel reservations, conventions, and sporting and entertainment events for which advance sales amounts, deposits, and wagers may have been collected. Entities will need to evaluate the appropriate timing of recognition, measurement, and classification of contract liabilities as a result of the impact of COVID-19 on overall global travel. Potential changes to cancellation policies or contract modifications could affect accounting for advance deposits; advance ticket sales for entertainment events; unpaid liabilities for ticket-in, ticket-out coupons (commonly referred to as "TITO coupons"); and race and sports wagers.
- Evaluation of key assumptions for estimating the customer loyalty program obligations since prolonged property closures and lower demand can affect such assumptions (e.g., estimated breakage of loyalty points). Changes to customer loyalty programs in light of current conditions, such as an entity's decision to voluntarily extend expiration terms, should be monitored and evaluated; these changes may result in more frequent revisions to breakage assumptions and estimates.
- Impairment of long-lived assets, including goodwill and other intangibles; management and franchise agreements; equity method investments; and PP&E.
- Valuation of key monetary assets for those amounts that have been capitalized for cash payments to customers (e.g., hotel owners) in connection with obtaining a franchise, a management agreement, or both. Key monetary payments are generally used by hotel owners to finance new hotel developments or major property renovations and are generally refundable to the franchisor or manager if the franchise or management contract is terminated.

- Liquidity and going-concern considerations resulting from declining revenues, which are driven by lower occupancy and declining price indicators (e.g., average daily rate) that will affect entities in this sector and are likely to be accompanied by additional costs associated with sanitization expenses, spoilage at food and beverage outlets, crisis management fees, expenditures related to cancellations of entertainment and convention events, and payroll and legal costs. Reductions in such metrics can pose significant challenges related to covenant compliance, liquidity, and going-concern issues.
- Close monitoring, in light of potential workforce shortages, of (1) casino entities' regulatory compliance and (2) minimum internal control requirements (as applicable) that are established and mandated by the relevant jurisdictional licensing bodies. Entities will also need to continue monitoring any existing and potential changes to regulatory requirements related to processes and procedures to be performed in the event of a temporary shutdown of gaming establishments.

Restaurants and Food Services

As a result of government-imposed closures, limitations on operating hours and services, professional sport league shutdowns, and uncertainties experienced by customers about the overall economy, many are staying at home and thereby reducing demand at restaurant and food service companies.

Noteworthy accounting considerations include:

- Evaluation of the accounting for, and estimation of amounts payable to, a franchisor for advertising funds and royalties in periods in which revenue at the franchisee level is significantly reduced or eliminated (e.g., evaluation of minimum payments in a contract).
- Evaluation of inventory for amounts that may not be salable before spoilage in geographies with significant closures.
- Evaluation of tenant occupancy clauses, which may provide rent relief if the mall, plaza, or center becomes vacant because of the prolonged effects of COVID-19.
- Impairment of long-lived assets (e.g., goodwill and other intangibles; ROU assets; and PP&E).
- Evaluation of key assumptions for estimating the customer loyalty program obligations since prolonged closures and lower demand can affect such assumptions (e.g., estimated breakage of loyalty points). Changes to customer loyalty programs in light of current conditions, such as an entity's decision to voluntarily extend expiration terms, should be monitored and evaluated; these changes may result in more frequent revisions to breakage assumptions and estimates.
- Liquidity and going-concern considerations resulting from potentially prolonged declines in revenue and demand.

Cruise Lines

Global cruise operations have experienced adverse effects of the spread of COVID-19, including growing port restrictions around the world. The cruise line sector is affected by many of the same factors that affect not only the airlines, restaurants, and retailers, but also hotels, where significant events affecting travel, including COVID-19, have an adverse impact on booking patterns. The extent of this effect is generally determined by the length of time in which the event influences travel decisions. The decline in global bookings for cruise line travel is exerting significant pressure on cruise lines operations. While reduced oil prices may have a positive impact on the cruise lines once they resume operations, the potential for significant reduction of future global bookings due to consumer sentiment and access to port locations remains a significant uncertainty. Prolonged reductions in consumer demand and related forward bookings will have an adverse impact on the overall liquidity of these companies, and many of them are taking actions to improve liquidity. Such actions include reducing capital expenditures and operating expenses, as well as evaluating other financing alternatives.

Noteworthy accounting considerations include:

- Impairment of long-lived assets (e.g., ships, goodwill and other intangibles) due to reductions in utilization and closed ports, profitability challenges resulting from declines in revenue and demand, and sharp declines in stock prices.
- Liquidity and financing considerations related to servicing debt obligations resulting from potentially prolonged declines in revenue and demand.
- Restructuring considerations related to potential staff reductions due to reductions in cruise itineraries or halting of sailing altogether.
- Evaluation of revenue recognition related to changes in cancellation policies, the associated impacts on performance obligations, and SSPs. Entities are experiencing significant cancellations and postponements of cruise line reservations for which advance sales amounts and deposits may have been collected.
- Liquidity and going-concern considerations resulting from declining revenues, which are driven by paused global fleet operations or lower occupancy and potentially declining ticket prices; these declines in revenue are likely to be accompanied by additional operating costs associated with sanitization expenses, crisis management fees, cancellation-related expenditures, and payroll and legal costs. Reductions in such metrics can pose significant challenges related to covenant compliance, liquidity, and going-concern issues.

Retail Sector

The retail sector is facing a number of challenges related to the impact of COVID-19. While some big-box mass merchants and supermarkets are seeing spikes in traffic, other retailers have been experiencing declines in traffic as consumers adjust their shopping patterns. In addition, many retailers have temporarily closed stores, and more retailers may choose to close for the short term as the pandemic evolves. There has been a shift in sales from in-store to online, which may increase shipping costs to the extent that they are not fully passed on to consumers.

Entities in the sector have also experienced disruptions in the supply chain, including those related to (1) competition for suppliers when acquiring raw materials, (2) decreased manufacturing capacity in certain locations, and (3) transportation patterns for merchandise. Many retailers are assessing the impact of production delays on inventory assortments and are considering options to mitigate the impact of such delays, including (1) a reassessment of the normal inventory logistics patterns and (2) increased use of air freight if available.

As a result of concerns about the workforce (corporate and store employees alike), employees may work remotely or be furloughed. Further, certain retailers that had been facing operational challenges before the pandemic, or that have high leverage ratios, could experience liquidity challenges if they are unable to adequately manage inventory, payroll, and rent during any prolonged period of revenue decline.

Noteworthy accounting considerations include:

- Costs related to potential staffing reductions due to store closures or significant declines in traffic.
- The impact of tenant occupancy clauses, which may provide rent relief if the mall or center becomes vacant.
- Negotiated rent relief provided by landlords, if available.
- Impairment of long-lived assets (e.g., store assets, ROU assets, goodwill and other intangibles) due to reductions in revenue and gross margin and possible declines in the stock prices of major retailers. Although depreciation generally does not cease when an asset is temporarily idled, if a retailer determines that operations will be restructured in response to the impact of the pandemic, impairment and useful lives of long-lived assets will need to be considered.
- Inventory obsolescence if a retailer will not be able to sell through merchandise.
- Penalties for any order cancellations, to the extent applicable.
- Changes in the volume or patterns of discounts and allowances provided to customers, which may affect revenue recognition.

- The potential to receive discounts or allowances from vendors if purchasing and sales volumes drop, which may affect the cost of revenue.
- Liquidity and financing considerations related to servicing debt obligations and covenant compliance, including the assessment of going concern, if revenue declines are significant.
- The consistent application of an SEC registrant's definition of same-store sales and other metrics, or transparent disclosure of any changes to such metrics.

Automotive Sector

The automotive industry has historically been a significant contributor to the global economy and has been widely exposed to many potential risks arising from COVID-19. These risks, include, but are not limited to, the following:

- Potential disruptions to global supply chains and the resulting disruption of production for original equipment manufacturers (OEMs) and suppliers.
- Impacts on consumer confidence and behavior that could potentially reduce consumer demand for automotive products and services. Such impacts could affect the entire automotive sector, including OEMs, suppliers, and retailers (independent automotive dealers and independent automotive parts and service retailers).
- Negative impacts on the global financial and credit markets, which could affect automotive companies' access to existing or new capital or could increase the cost of capital for automotive companies.

Noteworthy accounting considerations that may arise for the automotive sector include:

- *Impairment of nonfinancial assets (e.g., long-lived assets, amortized intangibles)* — Significant disruptions to supply or production, declines in consumer demand, or other relevant impacts may (1) represent events or changes in circumstances that indicate that the carrying amounts of certain nonfinancial assets might not be recoverable (requiring impairment tests for the affected nonfinancial assets) or (2) result in the abandonment or permanent idling of long-lived assets (resulting in accelerated depreciation or impairment charges).
- *Impairment of goodwill and indefinite-lived intangible assets* — Events and circumstances resulting from COVID-19 that indicate that it is more likely than not that the fair values of reporting units with goodwill and indefinite-lived intangible assets are less than the reporting units' carrying amounts would require interim impairment tests of goodwill and indefinite-lived intangibles between annual impairment testing dates.
- *Inventory valuation* — Periods of abnormally low production (for OEMs and suppliers) may limit the capitalization of certain costs (e.g., fixed overhead costs) in inventory. In addition, changes in consumer preferences or demand may affect the valuation of inventory held by automotive retailers (as well as OEMs and suppliers) or may result in excessive inventory levels.
- *Revenue recognition* — Changes in consumer preferences and demand may require OEMs to offer new incentive programs or maintain existing incentive programs for longer than expected. Doing so could have revenue recognition (variable consideration) implications for OEMs or make dealers more dependent on OEMs to move their inventories.
- *Restructuring activities* — In response to the impacts of COVID-19, automotive companies may implement restructuring actions (e.g., layoffs, contract terminations), the accounting for which can vary depending on the nature of the restructuring activity (e.g., voluntary vs. involuntary terminations, one-time termination benefits vs. benefits provided in accordance with a preexisting plan).
- *Credit losses* — The financial health of automotive companies' customers and, therefore, the collectibility of financial assets held by automotive companies, such as accounts receivable (including dealers' receivables from OEMs under incentive and other programs) and loans receivable (particularly for OEMs with captive financing subsidiaries) may be adversely affected. Any credit losses will need to be evaluated under ASC 310 or ASC 326, as applicable.

Appendix B — Entities Reporting Under IFRS Standards

The accounting and financial reporting considerations discussed in this publication are equally relevant to entities reporting under IFRS Standards. For example, it is likely that an indicator of impairment of PP&E under U.S. GAAP would also be an indicator of impairment under IFRS Standards. However, the underlying accounting guidance itself (e.g., the impairment test) often differs. For a comprehensive discussion of the differences between the two sets of standards, see Deloitte's *A Roadmap to Comparing IFRS Standards and U.S. GAAP: Bridging the Differences*.

The table below lists the major topics discussed in this publication, the relevant IFRS Standards and U.S. GAAP, and the sections of Deloitte's *A Roadmap to Comparing IFRS Standards and U.S. GAAP: Bridging the Differences* in which they are discussed in detail. For more information, see Deloitte's *IFRS in Focus — Accounting Considerations Related to the Coronavirus 2019 Disease*.

Topic	IFRS Standards	U.S. GAAP	Discussion in *A Roadmap to Comparing IFRS Standards and U.S. GAAP: Bridging the Differences*
Impairment — PP&E and finite-lived intangible assets	IAS 36	ASC 350 and ASC 360	Section 1.7
Impairment — indefinite-lived intangible assets and goodwill	IAS 36	ASC 350	Section 1.7
Leases	IFRS 16	ASC 842	Section 5.7
Inventory	IAS 2	ASC 330	Section 1.4
Contingencies (including restructurings)	IAS 37	ASC 420 and ASC 450	Section 2.2
Revenue recognition	IFRS 15	ASC 606	Section 3.1
Consolidation	IFRS 10 and IFRS 12	ASC 810	Section 5.2
Foreign currency transactions	IAS 21	ASC 830	Section 5.6
Employee benefits	IAS 19 and IFRIC Interpretation 14	ASC 420, ASC 710, ASC 712, and ASC 715	Section 2.1
Share-based payments	IFRS 2	ASC 718	Section 3.2
Impairment — financial assets	IFRS 9 and IAS 28	ASC 310, ASC 320, ASC 321, ASC 323, and ASC 326	Sections 1.1, 1.2, and 1.3
Derivatives and hedging	IFRS 9	ASC 815	Section 5.3
Fair value	IFRS 13	ASC 820	Section 5.4
Debt modifications and extinguishments	IFRS 9	ASC 470-50 and ASC 470-60	Section 2.3
Depreciation	IAS 16	ASC 360	Section 1.6
Noncurrent assets held for sale and discontinued operations	IFRS 5	ASC 360-10 and ASC 205-20	Section 4.2
Government grants	IAS 20	None[43]	Section 5.9
Income taxes	IAS 12 and IFRIC Interpretation 23	ASC 740	Section 3.3
Presentation of financial statements	IAS 1	ASC 205-10, ASC 220-10, ASC 505-10, ASC 810-10, and SEC Regulation S-X	Section 4.1
Statement of cash flows	IAS 1 and IAS 7	ASC 230-10	Section 4.3
Subsequent events	IAS 10	ASC 855	Section 5.9

[43] Under U.S. GAAP, there is no explicit guidance related to government grants or other forms of government assistance, other than industry guidance for not-for-profit entities.

Appendix C — Deloitte Contacts and Acknowledgments

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If you have questions about the information in this publication, please contact any of the following Deloitte professionals:

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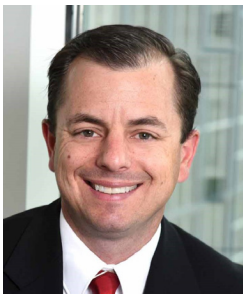

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Appendix D — Questions in DG Topics 9 and 9A

[Appendix added July 1, 2020]

DG Topics 9 and 9A contain questions for registrants to consider when developing disclosures related to the current and expected future impact of COVID-19. Those questions are reproduced below.

DG Topic 9 — Assessing and Disclosing the Evolving Impact of COVID-19

- How has COVID-19 impacted your financial condition and results of operations? In light of changing trends and the overall economic outlook, how do you expect COVID-19 to impact your future operating results and near-and-long-term financial condition? Do you expect that COVID-19 will impact future operations differently than how it affected the current period?
- How has COVID-19 impacted your capital and financial resources, including your overall liquidity position and outlook? Has your cost of or access to capital and funding sources, such as revolving credit facilities or other sources changed, or is it reasonably likely to change? Have your sources or uses of cash otherwise been materially impacted? Is there a material uncertainty about your ongoing ability to meet the covenants of your credit agreements? If a material liquidity deficiency has been identified, what course of action has the company taken or proposed to take to remedy the deficiency? Consider the requirement to disclose known trends and uncertainties as it relates to your ability to service your debt or other financial obligations, access the debt markets, including commercial paper or other short-term financing arrangements, maturity mismatches between borrowing sources and the assets funded by those sources, changes in terms requested by counterparties, changes in the valuation of collateral, and counterparty or customer risk.[3] Do you expect to disclose or incur any material COVID-19-related contingencies?
- How do you expect COVID-19 to affect assets on your balance sheet and your ability to timely account for those assets? For example, will there be significant changes in judgments in determining the fair-value of assets measured in accordance with U.S GAAP or IFRS?
- Do you anticipate any material impairments (e.g., with respect to goodwill, intangible assets, long-lived assets, right of use assets, investment securities), increases in allowances for credit losses, restructuring charges, other expenses, or changes in accounting judgments that have had or are reasonably likely to have a material impact on your financial statements?
- Have COVID-19-related circumstances such as remote work arrangements adversely affected your ability to maintain operations, including financial reporting systems, internal control over financial reporting and disclosure controls and procedures? If so, what changes in your controls have occurred during the current period that materially affect or are reasonably likely to materially affect your internal control over financial reporting? What challenges do you anticipate in your ability to maintain these systems and controls?
- Have you experienced challenges in implementing your business continuity plans or do you foresee requiring material expenditures to do so? Do you face any material resource constraints in implementing these plans?
- Do you expect COVID-19 to materially affect the demand for your products or services?
- Do you anticipate a material adverse impact of COVID-19 on your supply chain or the methods used to distribute your products or services? Do you expect the anticipated impact of COVID-19 to materially change the relationship between costs and revenues?
- Will your operations be materially impacted by any constraints or other impacts on your human capital resources and productivity?
- Are travel restrictions and border closures expected to have a material impact on your ability to operate and achieve your business goals?

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[3] See Commission Guidance on Presentation of Liquidity and Capital Resources Disclosures in Management's Discussion and Analysis, SEC Release No. 33-9144 (Sept. 28, 2010), available at https://www.sec.gov/rules/interp/2010/33-9144.pdf.

DG Topic 9A — Operations, Liquidity, and Capital Resources

- What are the material operational challenges that management and the Board of Directors are monitoring and evaluating? How and to what extent have you altered your operations, such as implementing health and safety policies for employees, contractors, and customers, to deal with these challenges, including challenges related to employees returning to the workplace? How are the changes impacting or reasonably likely to impact your financial condition and short- and long-term liquidity?
- How is your overall liquidity position and outlook evolving? To the extent COVID-19 is adversely impacting your revenues, consider whether such impacts are material to your sources and uses of funds, as well as the materiality of any assumptions you make about the magnitude and duration of COVID-19's impact on your revenues. Are any decreases in cash flow from operations having a material impact on your liquidity position and outlook?
- Have you accessed revolving lines of credit or raised capital in the public or private markets to address your liquidity needs? Are your disclosures regarding these actions and any unused liquidity sources providing investors with a complete discussion of your financial condition and liquidity?
- Have COVID-19 related impacts affected your ability to access your traditional funding sources on the same or reasonably similar terms as were available to you in recent periods? Have you provided additional collateral, guarantees, or equity to obtain funding? Have there been material changes in your cost of capital? How has a change, or a potential change, to your credit rating impacted your ability to access funding? Do your financing arrangements contain terms that limit your ability to obtain additional funding? If so, is the uncertainty of additional funding reasonably likely to result in your liquidity decreasing in a way that would result in you being unable to maintain current operations?
- Are you at material risk of not meeting covenants in your credit and other agreements?
- If you include metrics, such as cash burn rate or daily cash use, in your disclosures, are you providing a clear definition of the metric and explaining how management uses the metric in managing or monitoring liquidity?[2] Are there estimates or assumptions underlying such metrics the disclosure of which is necessary for the metric not to be misleading?
- Have you reduced your capital expenditures and if so, how? Have you reduced or suspended share repurchase programs or dividend payments? Have you ceased any material business operations or disposed of a material asset or line of business? Have you materially reduced or increased your human capital resource expenditures? Are any of these measures temporary in nature, and if so, how long do you expect to maintain them? What factors will you consider in deciding to extend or curtail these measures? What is the short- and long-term impact of these reductions on your ability to generate revenues and meet existing and future financial obligations?
- Are you able to timely service your debt and other obligations? Have you taken advantage of available payment deferrals, forbearance periods, or other concessions? What are those concessions and how long will they last? Do you foresee any liquidity challenges once those accommodations end?
- Have you altered terms with your customers, such as extended payment terms or refund periods, and if so, how have those actions materially affected your financial condition or liquidity? Did you provide concessions or modify terms of arrangements as a landlord or lender that will have a material impact? Have you modified other contractual arrangements in response to COVID-19 in such a way that the revised terms may materially impact your financial condition, liquidity, and capital resources?
- Are you relying on supplier finance programs, otherwise referred to as supply chain financing, structured trade payables, reverse factoring, or vendor financing, to manage your cash flow? Have these arrangements had a material impact on your balance sheet, statement of cash flows, or short- and long-term liquidity and if so, how?[3] What are the material terms of the arrangements? Did you or any of your subsidiaries provide guarantees related to these programs? Do you face a material risk if a party to the arrangement terminates it? What amounts payable at the end of the period relate to these arrangements, and what portion of these amounts has an intermediary already settled for you?
- Have you assessed the impact material events that occurred after the end of the reporting period, but before the financial statements were issued, have had or are reasonably likely to have on your liquidity and capital resources and considered whether disclosure of subsequent events in the financial statements and known trends or uncertainties in MD&A is required?

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[2] *See* Commission Guidance on Management's Discussion and Analysis of Financial Condition and Results of Operations, Release No. 33-10751 (Jan. 30, 2020), available at https://www.sec.gov/rules/interp/2020/33-10751.pdf.

[3] These programs vary widely in their terms and structures and often involve an intermediary, such as a financial institution. Companies should determine the appropriate balance sheet and cash flow classifications of obligations related to the programs, which also may impact how the programs are discussed in MD&A.

DG Topic 9A — Government Assistance — The Coronavirus Aid, Relief, and Economic Security Act (CARES Act)[4]

- How does a loan impact your financial condition, liquidity and capital resources? What are the material terms and conditions of any assistance you received, and do you anticipate being able to comply with them? Do those terms and conditions limit your ability to seek other sources of financing or affect your cost of capital? Do you reasonably expect restrictions, such as maintaining certain employment levels, to have a material impact on your revenues or income from continuing operations or to cause a material change in the relationship between costs and revenues? Once any such restrictions lapse, do you expect to change your operations in a material way?
- Are you taking advantage of any recent tax relief, and if so, how does that relief impact your short- and long-term liquidity? Do you expect a material tax refund for prior periods?
- Does the assistance involve new material accounting estimates or judgments that should be disclosed or materially change a prior critical accounting estimate? What accounting estimates were made, such as the probability a loan will be forgiven, and what uncertainties are involved in applying the related accounting guidance?[9]

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[4] *See* the Coronavirus Aid, Relief, and Economic Security Act, available at https://www.congress.gov/116/bills/hr748/BILLS-116hr748enr.pdf. . . .

[9] For example, the SEC staff would not object to a company accounting for a loan obtained under the Paycheck Protection Program in Section 1102 of the CARES Act as either (i) debt pursuant to ASC 470, or (ii) as a government grant by analogy to IAS 20, provided certain conditions are met (e.g., that it is probable that the registrant will meet the terms for forgiveness of the loan).

DG Topic 9A — A Company's Ability to Continue as a Going Concern

- Are there conditions and events that give rise to the substantial doubt about the company's ability to continue as a going concern? For example, have you defaulted on outstanding obligations? Have you faced labor challenges or a work stoppage?
- What are your plans to address these challenges? Have you implemented any portion of those plans?

Appendix E — Summary of Changes

The table below lists sections in which substantive changes were made since this publication's original issuance.

Topic	Date of Change	Type of Change
Executive Summary	April 13, 2020	Amended paragraph
Select SEC and PCAOB Announcements Related to COVID-19	April 13, 2020, and July 1, 2020	Amended paragraphs
Deadline Relief	April 13, 2020, May 7, 2020, July 1, 2020, and September 18, 2020	Amended section
Disclosure Guidance	April 13, 2020, and July 1, 2020	Amended section
Other Guidance and Relief	April 13, 2020, and July 1, 2020	Amended section
SEC Reporting and Disclosure Considerations	July 1, 2020	Amended section and added paragraph
MD&A	July 1, 2020	Added Connecting the Dots
Non-GAAP Measures	April 24, 2020, and July 1, 2020	Expanded section
Metrics and KPIs	July 1, 2020	Amended paragraph
Requirement to Develop Estimates, and Consistency of Assumptions and Estimates	September 18, 2020	Added disclosure considerations
Inventory	April 24, 2020, and September 18, 2020	Added paragraph and disclosure considerations
Costs to Obtain or Fulfill a Revenue Contract and Up-Front Payments to Customers	April 24, 2020	Amended paragraph
Indefinite-Lived Intangible Assets Other Than Goodwill	September 18, 2020	Added disclosure considerations
Long-Lived Assets	September 18, 2020	Added disclosure considerations
Leases (ASC 842) — Right-of-Use Assets	September 18, 2020	Added paragraph and disclosure considerations
Goodwill	April 24, 2020, and September 18, 2020	Amended paragraph, added footnotes and disclosure considerations
Impairment and Valuation Considerations	April 13, 2020, April 24, 2020, and September 18, 2020	Added paragraphs and disclosure considerations
Recognition of Interest Income	April 24, 2020, July 8, 2020, and September 18, 2020	Added section, paragraph, and disclosure considerations
Transfers/Sales of HTM Investments	April 13, 2020, and September 18, 2020	Amended section and added disclosure considerations
Transfers of Investments Into or Out of Trading Classification	April 13, 2020, and September 18, 2020	Added section and disclosure considerations
Classification of Current and Noncurrent Financial Liabilities	September 18, 2020	Added disclosure considerations
Renegotiation of Financial Liabilities	September 18, 2020	Added disclosure considerations

(Table continued)

Topic	Date of Change	Type of Change
Impact on Hedge Accounting	April 13, 2020, May 7, 2020, July 8, 2020, and September 18, 2020	Amended paragraph and added disclosure considerations
Fair Value Measurement and Disclosures	April 13, 2020	Amended paragraph
NPNS Election for Contracts That Meet the Definition of a Derivative	September 18, 2020	Added disclosure considerations
Earnings per Share	April 24, 2020, and September 18, 2020	Added paragraphs and disclosure considerations
Revenue Contracts With Customers	April 24, 2020	Amended section
Lease/Rent Concessions	April 13, 2020, and May 7, 2020	Amended section
Lessor Concession Offers	September 18, 2020	Amended paragraph and incorporated into added disclosure considerations
Consolidation and Equity Method Accounting	April 24, 2020, and May 7, 2020	Amended section and added paragraph
Equity Method Basis Differences	May 7, 2020	Added section
Change in Governance Rights Affecting the Party (or Parties) With Power to Direct the Activities of a VIE That Most Significantly Affect the VIE's Economic Performance	September 18, 2020	Added disclosure considerations
Plan Curtailments — Furloughs	April 24, 2020, and September 18, 2020	Added section and disclosure considerations
Stock Compensation	April 24, 2020	Amended section
Employee Termination Benefits	April 24, 2020	Amended section
Voluntary Termination Benefits	September 18, 2020	Added disclosure considerations
Compensated Absences	April 24, 2020, and September 18, 2020	Added section and disclosure considerations
Government Assistance	April 13, 2020	Amended section
Government Grants	September 18, 2020	Amended paragraph
Income Statement Classification Considerations	July 1, 2020	Added Connecting the Dots
Subsequent Events	April 13, 2020, and September 18, 2020	Added paragraph, amended section, and added disclosure considerations
Income Taxes	April 13, 2020, and September 18, 2020	Amended paragraph and added disclosure considerations
Banking and Finance Industry — Financial Instruments — Impairment and Valuation Considerations	April 13, 2020	Amended footnote
Banking and Finance Industry — Troubled Debt Restructurings	April 13, 2020, and January 11, 2021	Amended section
Banking and Finance Industry — Interest Income During Payment Holidays	April 13, 2020	Added section
Real Estate Industry — Rent Relief and Other Support for Tenants	April 13, 2020	Amended section
Appendix D — Questions in DG Topics 9 and 9A	July 1, 2020	Added appendix

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