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To the Point

Relief provided by the CARES Act will affect accounting and financial reporting

Careful analysis is necessary to determine whether an entity is eligible for relief under the CARES Act.

What you need to know

- The CARES Act, which provides an estimated $2.2 trillion to fight the COVID-19 pandemic and stimulate the US economy, will have accounting and financial reporting consequences for affected companies.
- Affected companies and their audit committees should monitor developments because several provisions will require federal agencies to establish rules and procedures to implement them.
- While a number of the Act's provisions will be reflected in future accounting periods, certain income tax accounting measures will need to be reflected in the period of enactment (i.e., the period including 27 March 2020).
- Certain government grants and loans provided by the Act come with conditions that will affect various areas of financial reporting, including compensation and disclosures.

Overview

The Coronavirus Aid, Relief, and Economic Security (CARES) Act, which was signed into law on 27 March 2020, provides an estimated $2.2 trillion to fight the COVID-19 pandemic and stimulate the US economy. The assistance includes tax relief and government loans, grants and investments for entities in affected industries (e.g., health care, airlines).

Because several of the Act's provisions will require federal agencies to establish rules and procedures to implement them, affected companies and their audit committees should monitor developments so they can further evaluate the effects on financial reporting.

Building a better working world

Key provisions

Taxes

The business tax provisions of the Act include temporary changes to income and non-income-based tax laws. Some of the key income tax provisions include:

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

Entities need to account for these provisions in the period that includes the 27 March 2020 enactment date (i.e., the first quarter for calendar year-end entities). They also may need to adjust the carrying value of deferred tax assets for NOL carryforwards and reassess their conclusions on valuation allowances in the reporting period that includes the enactment date.[1]

Measures not related to income-based taxes include (1) allowing an employer to pay its share of Social Security payroll taxes that would otherwise be due from the date of enactment through 31 December 2020 over the following two years and (2) allowing eligible employers subject to closure due to the COVID-19 pandemic to receive a 50% credit on qualified wages against their employment taxes each quarter, with any excess credits eligible for refunds.

Government loans, investments and grants

The Act provides up to $500 billion in loans, loan guarantees and investments to eligible businesses (e.g., passenger and cargo airlines) that have incurred or are expected to incur losses related to COVID-19. In some cases, this assistance will require the government to receive financial instruments (e.g., senior debt instruments, warrants) of the borrower. In addition, the borrower may have to agree to certain conditions, such as limits on its ability to furlough employees or reduce employee pay, buy back stock, make future payment of dividends on common stock and compensate highly paid workers.

Small businesses and not-for-profit entities (NFPs) that have experienced or are expected to experience significantly lower revenue are also eligible for additional government loans and grants. For example, the Act provides Small Business Administration (SBA) loans for qualifying small businesses and NFPs that employ fewer than 500 people, with certain exceptions. To participate, these entities need to certify that they have been affected by the pandemic and will use the funds to retain workers (e.g., by paying salaries and providing paid sick/medical leave and insurance benefits) and pay debts. Other grants may be used for education and training. SBA loans are eligible for forgiveness of amounts spent on the stipulated benefits, under certain conditions.

Other grants are intended to help the US health care system respond to the COVID-19 pandemic. For example, grants are available to help fund additional telehealth capacity and community health centers that are testing and treating patients for COVID-19.

How we see it

Some forms of government assistance may be a relief for entities with liquidity concerns. All entities should carefully consider the terms of any assistance that sets conditions that may have business and financial reporting implications (e.g., a limit on future dividends may conflict with existing investor requirements or expectations).

Many of the key provisions of the Act will have financial reporting consequences.

Entities should consider how participation in assistance programs may affect financial reporting in the following areas.

Government grant accounting

Because US GAAP generally does not contain specific guidance on the accounting for government grants, entities need to determine the appropriate accounting treatment. When the assistance received is in the form of a government grant and is not an income tax credit or loan and does not represent revenue (including contribution revenue), we generally believe the entity should account for it by analogy to International Accounting Standards (IAS) 20, *Accounting for Government Grants and Disclosure of Government Assistance*.

Debt and equity accounting

Entities that receive government assistance should carefully evaluate if any provisions of the Act may require the government to receive financial instruments (e.g., debt, equity). Issuing financial instruments that combine features of debt and equity or equity-like features may require a complex accounting analysis of the instruments, both at issuance and on an ongoing basis.[2]

Compensation

Borrowers may be compelled to modify or cancel compensation arrangements with highly paid workers to reflect limits on compensation, severance and other benefits paid to these employees. Generally, modifications or cancellations of cash compensation arrangements and liability-classified share-based payment awards result in the reversal of the related compensation costs. However, modifications or cancellations of equity-classified share-based payment awards that have vested or are probable of vesting do not result in the reversal of compensation costs and may result in the acceleration of previously unrecognized compensation cost.[3]

The Act also allows employers to delay contributions for single employer defined benefit pension plans until 1 January 2021. While delaying contributions will affect the actual return on plan assets for the year, we do not believe that an employer can adjust the expected return component of the net periodic benefit cost unless there is a significant event, as defined in Accounting Standards Codification (ASC) 715-30, that requires a remeasurement of plan assets and obligations. An employer may not consider delayed contributions in the plan's funded status under ASC 715, even though the plan may consider them to be assets (i.e., contributions receivable) under ASC 960.

Going concern

An entity will need to consider whether and how accepting government assistance may affect management's evaluation of the entity's ability to continue as a going concern within one year after the date the financial statements are issued (or available to be issued, when applicable) under ASC 205-40. As a reminder, disclosures in the notes to the financial statements are required if management concludes that substantial doubt exists or that its plans alleviate that substantial doubt.

Deferral of certain loan accounting and ASC 326

The Act allows financial institutions to elect not to apply the guidance in ASC 310-40 on accounting for troubled debt restructurings (TDRs) to loan modifications related to COVID-19 made between 1 March 2020 and the earlier of (1) 31 December 2020 or (2) 60 days after the end of the COVID-19 national emergency. The relief can be applied to modifications for borrowers that were not more than 30 days past due as of 31 December 2019.

Insured depository institutions, bank holding companies and their affiliates are also allowed to temporarily not apply the new credit losses guidance in ASC 326 from the date of enactment to the earlier of (1) 31 December 2020 or (2) the end of the COVID-19 national emergency.

It's not clear how the deferral provisions relating to TDRs and the new credit losses standard would be applied. We will provide updates as this becomes clearer.

Revenue recognition

The Act clarifies that all COVID-19 testing, preventive services and vaccines are to be provided by private insurance plans without cost sharing. The Act also delays certain Medicare and Medicaid cuts (e.g., Medicare sequestration, disproportionate share hospital (DSH) reductions) and extends certain other government programs.

Health care providers need to carefully evaluate the provisions to determine the effect on revenue recognized from contracts with customers (i.e., COVID-19 patients). For example, health care providers may need to update their estimates of variable consideration based on amounts expected to be paid by private insurance, rather than patients. Changes in amounts paid by the Centers for Medicare & Medicaid Services (CMS) may also affect the revenue recognized for COVID-19 services. Further, any accelerated or advance payments a health care provider receives from CMS before providing patient services would be recorded as a contract liability under the revenue guidance in ASC 606.

Life science entities also may be affected by provisions in the Act that enable the Food and Drug Administration to expedite the review of certain drug applications and inspections to prevent or mitigate drug shortages. This may require life science entities to consider whether an update is needed for estimates of variable consideration associated with contracts to develop, manufacture and commercialize drug formulas.[4]

Endnotes:

[1] Refer to our Financial reporting developments (FRD) publication, ***Income taxes***, for additional information on the accounting for the effects of tax law changes and valuation allowances.

[2] Refer to our FRD, ***Issuer's accounting for debt and equity financings***, for more guidance.

[3] Refer to section 8 of our FRDs, ***Share-based payment (before the adoption of ASU 2018-07,* Improvements to Nonemployee Share-Based Payment Accounting*)*** and ***Share-based payment (after the adoption of ASU 2018-07,* Improvements to Nonemployee Share-Based Payment Accounting*)***.

[4] See our FRD, ***Revenue from contracts with customers (ASC 606)***, for further information, as well as our industry Technical Lines, ***How the new revenue standard affects health care entities*** and ***How the new revenue standard affects life sciences entities***.