

To the Point

SEC Chief Accountant emphasizes need for high-quality financial reporting relating to COVID-19

The SEC staff will not object to eligible entities concluding that electing the CARES Act relief on TDRs or the option to defer the new credit losses standard complies with US GAAP.

What you need to know

- ▶ The SEC's Chief Accountant issued a statement emphasizing the need to provide investors and other stakeholders with the high-quality financial information they need to make decisions amid the uncertainty resulting from the COVID-19 pandemic.
- ▶ If eligible entities elect to apply the temporary relief from TDR accounting or elect to defer the adoption of the new credit losses standard, the SEC staff would not object to the conclusion that these actions comply with US GAAP for the periods the relief is provided by the CARES Act.
- ▶ The CARES Act limits the temporary relief from TDR accounting to "financial institutions" and allows only banks, bank holding companies, credit unions and their affiliates to defer adoption of the credit losses standard. Based on discussions with the SEC staff, we understand this relief will not be more broadly available.
- ▶ Eligible calendar-year entities that elect to defer adoption of the credit losses standard must do so before making any quarterly filings with the SEC in 2020.
- ▶ While eligible entities can defer adoption to the earlier of the date the national emergency ends or 31 December 2020, they will need to restate their year-to-date results when they adopt the standard to reflect its application as of the beginning of their fiscal year (e.g., 1 January 2020 for a calendar-year entity).

Overview

Sagar Teotia, the Chief Accountant of the Securities and Exchange Commission (SEC), issued a **statement** urging all participants in the financial reporting system to continue working together to provide investors with the high-quality financial information they need to make decisions in light of the uncertainty resulting from COVID-19.

Mr. Teotia emphasized in the statement that entities may need to make significant judgments and estimates related to the effects of COVID-19. While stressing the importance of making the required disclosures about judgments and estimates, he emphasized that the SEC staff will not object to well-reasoned judgments.

The statement also clarified that the SEC staff will not object to an eligible entity concluding that electing to apply the temporary relief from troubled debt restructuring (TDR) accounting for loan modifications or the optional deferral of the new credit losses standard provided by the **Coronavirus Aid, Relief, and Economic Security (CARES) Act** is in accordance with US GAAP for the periods for which they are available.

Several questions have arisen as to how the provisions related to TDRs and credit losses in the CARES Act should be interpreted. Based on discussions with the SEC staff, we understand that these provisions are expected to be available only to eligible institutions during the periods described in the legislation.

The statement also described the work the SEC's Office of the Chief Accountant (OCA) has done engaging with stakeholders across the global financial reporting system, including preparers, auditors, audit committee members, investors, standard setters and other regulators. In addition, it encouraged stakeholders to contact the SEC's OCA with questions about financial reporting related to COVID-19.

Key considerations

The SEC's Chief Accountant noted that significant judgments and estimates related to the effects of COVID-19 that entities may need to make include those in the following areas:

- ▶ Fair value and impairment considerations
- ▶ Leases
- ▶ Debt modifications or restructurings
- ▶ Hedging
- ▶ Revenue recognition
- ▶ Income taxes
- ▶ Going concern
- ▶ Subsequent events
- ▶ Adoption of new accounting standards (e.g., the new credit losses standard)

The statement noted that the OCA has consistently not objected to well-reasoned judgments that entities have made and said it would continue to apply this approach. The statement also stressed the importance of making the required disclosures about judgments and estimates.

CARES Act

The Chief Accountant's statement on the CARES Act relief that would allow eligible entities to temporarily suspend or defer two provisions of US GAAP was prompted by inquiries the OCA had received from companies and their auditors. The SEC staff responded that it will not object to the conclusion that such elections by an eligible entity were in accordance with US GAAP for the applicable periods.

Accounting for loan modifications

The CARES Act allows financial institutions to elect not to consider whether loan modifications relating to COVID-19 that they make between 1 March 2020 and the earlier of 31 December 2020 or 60 days after the national emergency related to COVID-19 ends are TDRs that would require accounting consequences. The relief can be applied to modifications of loans to borrowers that were not more than 30 days past due as of 31 December 2019.

Based on discussions with the SEC staff, we do not expect that the TDR relief provided for in the CARES Act will be extended to entities that are not financial institutions. Entities with lending activities that are not banks, bank holding companies, credit unions or their affiliates should work with legal counsel to evaluate their eligibility.

How we see it

We understand other questions have been raised about the application of the TDR guidance and its interaction with guidance recently issued by several banking regulators. We continue to work with regulators and standard setters to resolve any significant questions and encourage affected entities to monitor developments from the Financial Accounting Standards Board (FASB) and the banking regulators. The FASB is scheduled to discuss the accounting for loan modifications at its meeting this week.

Eligible entities that elect to defer adoption of the new credit losses standard will have to restate their year-to-date results once they adopt the standard to reflect its application as of the beginning of their fiscal year.

Option to defer the adoption of the credit losses standard

The CARES Act allows insured depository institutions, bank holding companies, credit unions and their affiliates to defer the adoption of the new credit losses standard. These entities would not have to apply the new credit losses standard from 27 March 2020 (the date the CARES Act was enacted) until the earlier of the date the national emergency related to COVID-19 ends or 31 December 2020.

Based on discussions with the SEC staff, we understand that an entity that elects to defer adoption of the standard must make that election before filing any financial statements related to the fiscal year that begins in 2020. That means that the election must be made before a calendar year-end public company issues its first quarter Form 10-Q.

Additionally, we understand that a calendar-year company should apply the election as of 1 January 2020. That is, a calendar-year company that makes this election would apply the legacy incurred loss model from 1 January 2020 through the date that the COVID-19 emergency ends or 31 December 2020, whichever is earlier.

Such an entity would be required to adopt the credit losses standard after the date that the COVID-19 emergency is terminated or 31 December 2020, whichever is earlier. Based on discussions with the SEC staff, we believe that the effect of that adoption should be presented as of 1 January 2020 for a calendar year-end company.

This means that if the COVID-19 emergency ends on 1 September 2020, an entity that elected to defer adoption would present credit losses using the legacy incurred loss model for its first- and second-quarter financial statements. However, in its third-quarter financial statements, the entity would reflect the adoption of the new standard as of 1 January 2020 and restate all year-to-date information presented. Because the latest date the deferral would be in effect is 31 December 2020, any calendar-year end entity that elects to defer the adoption will need to reflect the effects of adoption in its full-year financial statements included in its 2020 Form 10-K.

How we see it

Significant uncertainty exists about when the COVID-19 emergency will end, and we understand that ending the emergency will require formal action. Entities that are considering a deferral should make sure they are prepared to adopt the standard when the emergency ends. They will also need to continue providing the qualitative and quantitative disclosures about the effects of adoption of the standard required by SEC Staff Accounting Bulletin Topic 11.M. Entities should also consider the guidance issued by the banking regulators that provided additional capital relief for entities that adopted the new credit losses standard.

Audit issues

The statement said the SEC's OCA is actively engaged with the Public Company Accounting Oversight Board (PCAOB) to address emerging issues related to COVID-19 and supports the PCAOB's actions, including its [announcement](#) of suspensions of audit inspections for 45 days. The statement also emphasized the importance of auditor independence during this time and said it is a shared responsibility among audit committees, management and independent auditors.

Next steps

Entities should monitor developments at the FASB and actions by banking regulators. They should also consider using the 45-day extension provided by the SEC for filings due through 1 July 2020 if they need more time to determine whether to use the temporary relief provided by the CARES Act and make judgments related to the effects of COVID-19. The filing relief provided by the SEC is similar to the grace period that has long been available under Rule 12b-25, and affected registrants should not be reluctant to use it. Historically, we have not observed any negative consequences associated with taking advantage of the Rule 12b-25 grace period when circumstances warrant it.