KPMG addresses key accounting and financial reporting impacts of the CARES Act and subsequent relief bills on companies applying US GAAP.

### Background and key provisions

On March 27, 2020, US President Donald Trump signed into law the Coronavirus Aid, Relief, and Economic Security (CARES) Act. This was the third COVID-19 focused relief bill enacted into law in response to the outbreak and by far the largest in terms of scope and cost (surpassing $2 trillion dollars). Since then, two further COVID-19 relief bills have been enacted into law.

- On June 5, 2020, the Paycheck Protection Program Flexibility Act of 2020 was signed into law, which revised certain provisions of the Paycheck Protection Program created by the CARES Act.
- On December 27, 2020, the Consolidated Appropriations Act, 2021 was signed into law. Along with providing funding for normal government operations ($1.4 trillion), this bill provides for additional COVID-19 focused relief ($900 billion). The CAA extends certain provisions of the CARES Act, provides additional funding for others and contains new relief provisions.

All references hereafter to the ‘CARES Act’ or the ‘Act’ refer to the CARES Act, as amended by the Paycheck Protection Program Flexibility Act of 2020. All references to the ‘CAA’ refer to the Consolidated Appropriations Act, 2021.

Key provisions of the CARES Act and the CAA that impact companies reporting under US GAAP include the following.

- **Income taxes.** The CARES Act provides various forms of income tax relief to companies as follows.

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1. New guidance or significant updates were added in December 2020 to reflect the COVID-19 relief provisions of the CAA. Updated sections are indicated with #, while new sections are indicated with **. In addition, discussions specific to the provisions of the CAA within a pre-existing section are included in blue boxes within those sections to differentiate them from discussions of pre-existing CARES Act provisions.

2. Companies should consult legal and tax professionals for advice about how to interpret the detailed provisions of the CARES Act and the CAA.
- Enacts additional carryback opportunities for net operating losses (NOLs), and a company can now offset 100% of its taxable income with NOLs (as opposed to only 80% before the Act’s enactment).
- Temporarily increases the interest deductibility threshold from 30% to 50% of adjusted taxable income.
- Accelerates refunds of any remaining alternative minimum tax (AMT) carryforwards to the 2019 tax year from 2020 and/or 2021.
- Changes the depreciable life of qualified improvement property to 15 years for income tax purposes, which makes it eligible for bonus depreciation.

The CAA includes the following income tax provisions.
- Clarifies that gross taxable income does not include forgiven PPP loan amounts and allows borrowers to deduct otherwise allowable expenses paid with the proceeds, even if the loans are forgiven. These provisions are retroactively effective from the date of CARES Act enactment (March 27, 2020).
- Clarifies that gross taxable income does not include other (non-PPP) loan forgiveness, emergency Economic Injury Disaster Loan (EIDL) grants or loan repayment assistance provided by the CARES Act and allows taxpayers to deduct otherwise allowable expenses paid with the proceeds. These provisions are effective for tax years ending after the date of CARES Act enactment.
- Clarifies that the provisions in the preceding bullet also apply to Targeted EIDL advances and Grants for Shuttered Venue Operators (see discussion of these grants below), effective for tax years ending after the date of CAA enactment (December 27, 2020).
- Extends (or makes permanent) several temporary tax measures and introduces new ones.

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**Employee retention credit (ERC) and payroll taxes.** The CARES Act:
- Permits most companies to defer paying their portion of applicable payroll taxes from the date the Act was signed into law through December 31, 2020. The deferred amount would be due in two equal installments on December 31, 2021 and December 31, 2022.
- Grants the Employee Retention Credit (ERC) to eligible companies for each calendar quarter in an amount equal to 50% of qualified wages. The credit is first claimed against the company’s owed payroll taxes (net of credits otherwise allowed under the Internal Revenue Code) for the quarter. If the aggregate credit exceeds the company’s owed payroll taxes, the excess is refundable to the company. A company that obtains a PPP loan (see next item) is ineligible for the ERC (however, see the CAA amendments below).
- Permits advance refunding of payroll tax credits for paid sick leave and paid family leave enacted in the Families First Coronavirus Response Act (FFCRA).

On August 8, 2020, President Trump issued an executive order to permit employers to defer withholding employees’ share of social security taxes (or railroad retirement tax equivalent) from September 1, 2020 through December 31, 2020. Employers were required to repay the deferred amounts from increased employee withholdings ratably over the period January 1, 2021 to April 30, 2021. The CAA extends the additional withholdings and repayment period through December 31, 2021.
The CAA also:

- Extends and expands the ERC. Key provisions (not exhaustive) include:
  - Companies that receive a PPP loan can qualify for the ERC for wages not paid with forgiven PPP loan proceeds;
  - Group health plan costs are ‘qualified wages’ even if no other wages are paid to the employee
  - The ERC now applies to wages paid between March 12, 2020 through June 30, 2021 (versus through December 31, 2020);
  - The definition of a ‘large employer’ is increased from one with greater than 100 full-time employees (FTEs) to one with greater than 500 FTEs;
  - Per employee qualified wages are increased from $10,000 per calendar year to $10,000 per quarter;
  - The ERC is increased from 50% to 70% of qualified wages; and
  - The required gross receipts decline to qualify for the ERC is reduced from 50% to 20%, and companies are permitted to use the prior quarter’s gross receipts to qualify.

The first 2 changes apply retroactively to March 12, 2020, as if the changed provisions had always been part of the CARES Act. The final 5 changes apply to calendar quarters beginning with the first quarter of 2021.

- Extends the refundable payroll tax credits for paid sick leave and paid family leave required by the FFCRA through March 31, 2021, and modifies them accordingly. These provisions are effective as if enacted in the FFCRA.

### Paycheck Protection Program (PPP)

Key terms of the PPP loan program include the following.

- Companies requesting a PPP loan must meet certain eligibility requirements (e.g. size of business) and make a good faith certification that the current economic conditions make the loan necessary to support ongoing operations. Companies evaluate current business activity and the ability to obtain other sources of liquidity when making this certification. It is unlikely that a public company with substantial market value and access to public markets would be able to make this certification. Large private companies (including not-for-profit entities) with adequate sources of liquidity may also be challenged and required to demonstrate to the SBA, on request, the basis for their certifications.³

- The loans are 100% guaranteed.

- The loans have a maximum principal amount of $10 million per company (or a lesser amount that depends on the company’s payroll).

- The loans have a minimum term of 5 years, which can be extended for up to 5 additional years if the lender and the borrower both agree.

- Loan recipients will benefit from an extended deferment on payments, a low interest rate (1%), and waived personal guarantee and collateral requirements. The PPP also waives borrower fees.

- The entire principal amount and any accrued interest on the loan is eligible for forgiveness to the extent the proceeds are used to make payroll, payroll-related and other eligible payments (however, no more than 40% may be for ‘other eligible payments’). Other eligible payments include rent, mortgage interest, insurance premiums, utilities and interest on pre-existing debt (incurred before February 15, 2020). Except where permitted by the Act, the portion eligible for forgiveness is reduced if the company reduces its workforce or compensation levels.

³ Paycheck Protection Program Loans – Frequently Asked Questions.
- Lenders will receive pre-determined fees for processing and servicing the PPP loans.

The CAA amends the PPP. A number of the key amendments are outlined below; however, the list is not exhaustive. The CAA includes other detailed provisions related to the PPP, including some that apply only to certain companies (e.g. certain news organizations or ‘seasonal employers’). The CAA:

- Extends the PPP to March 31, 2021 and its maximum loan amounts to $806.5 billion.
- Prohibits publicly traded companies from obtaining PPP loans.
- Expands what payments qualify as ‘other eligible payments’ in the discussion above. Borrowers can apply the expanded eligibility provisions to PPP loans made before CAA enactment provided that the loans have not already been forgiven. Other eligible payments now include payments for:
  - software, cloud computing and other human resource or accounting needs;
  - property damage from ‘public disturbances’ that occurred in 2020 not covered by insurance;
  - goods essential to the borrower’s operations at the time the payment was made, subject to a contract or purchase order in effect before taking out the PPP loan; and
  - costs incurred between March 1, 2020 and the date the COVID-19 national emergency comes to an end for (1) personal protective equipment and (2) business changes (e.g. changes to facilities or operational procedures) to comply with federal, state or local COVID-19 health and safety guidelines.
- Clarifies that gross income does not include forgiven PPP loan amounts, and permits deduction of otherwise deductible expenses paid with the proceeds of a forgiven PPP loan, for income tax purposes. See Income taxes section above.
- Permits eligible companies to obtain a second PPP loan (‘second draw’) under terms specified in the CAA, with a maximum amount of $2 million. Companies cannot obtain more than one second draw loan. Second draw PPP borrowers are eligible for loan forgiveness on the same terms as first draw PPP borrowers. Eligibility requirements for a second draw PPP loan include:
  - 300 employees or fewer;
  - have used or will use the full amount of the first draw PPP loan; and
  - a 25% or greater decrease in company gross receipts in the first, second or third quarter of 2020 as compared with the same 2019 quarter (a company may use the fourth quarter of those years on loan applications submitted after January 1, 2021).

Entities engaged in political or lobbying activities, registered under the Foreign Agents Registration Act, or affiliated with entities in China are not eligible.

- Establishes that the interest on PPP loans is non-compounding and the interest rate is not adjustable for all new PPP loans (first or second draw).
- Prohibits companies that receive a Shuttered Venue Operator Grant from obtaining a PPP loan (first or second draw).
- Lenders permitted to approve first draw PPP loans are permitted to approve second draw loans. Like first draw PPP loans, the CAA establishes pre-determined fees for processing and servicing the second draw PPP loans.

**Industry-specific loan program (ISLP).** ISLP appropriates up to $46 billion for loans and loan guarantees, not to exceed 5 years and to bear interest based on pre-COVID-19 market rates, to passenger airlines (and related businesses, such as those that provide maintenance services or
replacement parts), cargo air carriers and ‘businesses critical to maintaining national security’. A company obtaining a loan or a guarantee under the ISLP must meet specified requirements, including that it has incurred losses stemming from COVID-19 and other business credit is not reasonably available to it. Unlike the PPP loans, no portion of an ISLP loan is forgivable.

To obtain the loan or loan guarantee, the company must agree to a number of conditions including, but not limited to, the following.

- It will not make any company share repurchases or dividend payments until 12 months after the loan is repaid or loan guarantee lifted (previously existing contractual obligations excepted).
- It will retain existing employees ‘to the extent practicable’ through September 30, 2020, but in no instance reduce its workforce by more than 10% from March 24, 2020 levels.
- It will secure the loan ‘sufficiently’, or accept an appropriate risk-based interest rate adjustment.
- If a public company, it will grant the Treasury a stock warrant or other equity interest.
- If not a public company, it will grant the Treasury (at Treasury’s option) either: (1) a stock warrant or other equity interest or (2) a senior debt instrument.

Warrants (or other equity interests) and senior debt instruments must meet specific conditions in the CARES Act. These include that any warrant or other equity interest permit the Treasury to share in equity value increases and that any senior debt provide an appropriate interest rate premium. Treasury may sell, exercise or surrender any warrant or other equity or debt instrument, but will not exercise voting rights with respect to any common shares acquired.

**Loan programs for other larger businesses (LPLB).** LPLB appropriates up to $454 billion for loans and loan guarantees to businesses not eligible under the PPP or ISLP. Like the ISLP loans, no portion of the loans is forgivable. A company obtaining a loan or a guarantee under the LPLB must meet specified requirements and agree to a number of conditions including, but not limited to, the following.

- It will not make any company share repurchases or dividend payments until 12 months after the loan is repaid or loan guarantee lifted (previously existing contractual obligations excepted).
- It will retain existing employees ‘to the extent practicable’ through September 30, 2020, but in no instance reduce its workforce by more than 10% from March 24, 2020 levels.
- It will comply with employee compensation limits established by the Act.

‘Mid-sized businesses’ (those with between 500 and 10,000 employees) are eligible for loans under the LPLB. In addition to the requirements in the preceding paragraph, a mid-sized company accepting an LPLB loan must meet a number of other requirements, including representing that:

- the proceeds of the loan will be used to retain at least 90% of its workforce until September 30, 2020 (at full compensation and benefits); and
- it will not outsource or offshore jobs until two years after the loan is repaid.

**Modifications to loan and debt relief programs.** The CAA modifies a number of existing loan programs (e.g. 7(a) loans, Microloans, 504 loans). Refer to the CAA for details of these amendments.

**Pandemic relief for aviation workers (PRAW).** PRAW provides grants to passenger airlines, cargo air carriers and related contractors in an aggregate amount of $32 billion to be exclusively used for payment of employee payroll and payroll-related costs. The Act permits the Treasury to receive warrants, options, preferred stock, debt securities, notes or other financial instruments issued by recipients of this financial assistance.
The CAA provides for an additional $15 billion and $1 billion in PRAW grants to passenger airlines and related contractors, respectively. Consistent with the grants under the CARES Act, these funds are to be exclusively used for the payment of employee payroll and payroll-related costs and Treasury is authorized to receive warrants, options, preferred stock, debt securities, notes or other financial instruments issued by recipients of this financial assistance.

Companies will receive funding in amounts proportional to what they received from grants under the CARES Act. If a company did not receive a CARES Act PRAW grant, it is still eligible to receive one from the new CAA funds based on a formula to be determined by the Treasury Secretary.

To receive new grants, the company is required to:

- recall involuntary furloughed employees;
- back pay returning employees and restore rights and protections to those employees to a status as if they had not been furloughed;
- refrain from instituting involuntary layoffs or furloughs, or reducing pay or benefits, until March 31, 2021 (or until all PRAW funds are expended, if later);
- refrain from instituting stock buybacks (of the company or a parent company), paying common stock dividends, or making other capital distributions until March 31, 2021 (or until all PRAW funds are expended, if later); and
- limit the total compensation of company officers and employees.

— Relief for transportation services.** The CAA authorizes up to $2 billion in grant money for transportation operators other than airlines (e.g. bus, motor coach, ferry operators) that have experienced a ‘revenue loss’ of at least 25% year-over-year because of COVID-19. Conditions to obtain, and requirements on the use (and possible return) of, grant funds are similar in nature to those for shuttered venue operators.

— Grants for shuttered venue operators.** The CAA authorizes up to $15 billion in grant money to certain venue operators that demonstrate a 25% reduction in ‘gross earned revenue’ in the first, second or third quarter of 2020 as compared with the same 2019 quarter (a company may use the fourth quarter of those years on loan applications submitted after January 1, 2021). These grants will be administered by the SBA and made available to eligible live-venue operators or promoters, live performing arts organization operators, museum operators, motion picture theater operators and talent representatives (for which the CAA provides detailed definitions).

During the initial 14-day implementation period of the program, grants will be awarded only to eligible entities that demonstrate at least a 90% gross earned revenue decline. For the 14 days after that, grants will be awarded only to eligible entities that demonstrate at least a 70% gross earned revenue decline.

An entity may apply for a supplemental grant of up to 50% of the initial grant amount. The maximum total grant amount (i.e. initial and supplemental grants in total) cannot exceed $10 million.

Grant money is to be used for specified eligible expenses, subject to SBA oversight. Eligible expenses include:

- payroll costs;
- rent;
- utilities;
- mortgage interest or principal;
- interest or principal on debt incurred before February 15, 2020;
worker protection expenditures (e.g. personal protective equipment and the cost of changes to facilities or operational procedures);
- payments to independent contractors (not to exceed a total of $100,000 in annual compensation for any individual employee of an independent contractor); and
- ‘other ordinary and necessary business expenses’ (e.g. maintenance expenses; state and local taxes and fees; insurance premiums; advertising, production, transportation and capital expenditures related to producing a theatrical or live performing arts production).

Initial grant funds unspent on eligible expenses one year after grant disbursement are required to be returned unless the entity also receives a supplemental grant, in which case unspent funds under either the initial or supplemental grant must be returned if not spent 18 months after the initial grant disbursement.

— **Emergency broadband benefit program.** Under the CAA, eligible households may receive a discount of between $50 and $75 of internet service costs and a subsidy for low-cost devices (e.g. tablets). Internet service providers that grant eligible households these discounts are eligible for reimbursement from the FCC.

— **Broadband connectivity grants.** Broadband providers are eligible for grants under the CAA, through qualifying partnerships with state or local governments, for building out broadband infrastructure in underserved areas (especially rural areas).

— **Government grants to healthcare providers.** The CARES Act provides up to $100 billion for hospitals responding to the COVID-19 outbreak and $1.3 billion for community health centers.

| The CAA explicitly allocates $3 billion in additional grants for hospitals and health care providers for lost revenue and expenses directly related to COVID-19. | The CAA also includes approximately $73 billion in funding for COVID-19 related health activities, including (not exhaustive): public health; research, development, manufacturing, procurement, and distribution of vaccines and therapeutics; diagnostic testing and contact tracing; mental health and substance abuse prevention and treatment services. This funding will flow to companies and other entities involved in these activities. |
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— **CDFI/MDI assistance.** The Treasury is provided $9 billion to provide emergency capital investment in Community Development Financial Institutions (CDFIs) and Minority Depository Institutions (MDIs) through purchases of preferred stock and other financial instruments from eligible institutions. $2 billion of the total is set aside for each of: (1) institutions with under $2 billion in total assets and (2) institutions with under $500 million in total assets

- Purchases may continue until 6 months after the COVID-19 emergency has been terminated.
- Participants must develop and comply with a plan to maintain or expand significant lending or investment activity in ‘low- and moderate-income minority communities’, especially those disproportionately impacted by COVID-19, and minorities with significant unmet capital or financial services needs.

The Treasury is provided a further $3 billion in funding for the CDFI Fund to be used as emergency grants to assist CDFIs that respond to economic impacts of COVID-19. $1.25 billion is available for the current fiscal year. The remaining $1.75 billion will be available until it is expended; however, $1.2 billion is reserved for ‘minority lending institutions’, a new category of CDFI comprising institutions that predominantly serve minority communities and are either MDIs or meet other standards for accountability to minority populations as determined by the CDFI Fund.
— **Optional credit losses standard (CECL) deferral.** The CARES Act permits specified companies – insured depository institutions, bank holding companies and affiliates of either – to defer compliance with the credit loss requirements of Topic 326 (financial instruments—credit losses) until the earlier of:

- the date the COVID-19 national emergency comes to an end; and

The CAA extends the CECL deferral until the earlier of:

- the first day of a company’s fiscal year that begins after the date the COVID-19 national emergency comes to an end; and
- January 1, 2022.

— **Troubled debt restructurings (TDRs).** A ‘financial institution’ may elect not to apply the TDR guidance in Topic 310 to loan modifications that would otherwise be subject to that guidance. This relief from TDR accounting applies only to modifications that meet the following conditions:

- the loan was not more than 30 days past due as of December 31, 2019;
- the modification is related to the COVID-19 outbreak; and
- the modification was executed between March 1, 2020 and the earlier of (1) 60 days following the date the COVID-19 national emergency comes to an end and (2) December 31, 2020.

The CAA modifies the third condition above. The relief from TDR accounting will now apply to modifications executed between March 1, 2020 and the earlier of (1) 60 days following the date the COVID-19 national emergency comes to an end and (2) January 1, 2022.

The CAA also clarifies that insurance companies are eligible for this temporary relief.

— **Mortgage relief.** During the covered period, a borrower (single or multi-family) with a federally backed mortgage loan experiencing a financial hardship due, directly or indirectly, to the COVID-19 emergency may request forbearance on the federally backed mortgage loan. In addition, unless a property is vacant or abandoned, servicers of federally backed mortgage loans may not initiate new foreclosure processes, move for a foreclosure judgment or order of sale, or execute a foreclosure-related eviction or foreclosure sales for 60 days beginning on March 18, 2020.

— **Lease eviction moratorium.** Landlords of housing properties that participate in a covered housing program, participate in the rural housing voucher program or have a federally backed mortgage loan are prohibited from initiating new eviction proceedings for non-payment of rent or other fees, or charging fees or penalties related thereto, for 120 days from March 27, 2020. In addition, landlords of these covered properties must give tenants at least 30 days’ notice of eviction, and such eviction notice cannot be given until the end of the 120-day moratorium.

— **CDC residential eviction moratorium.** The CAA extends the agency order issued by the Centers for Disease Control (CDC) through January 31, 2021 (from December 31, 2020). Under the CDC order, landlords, owners, and “other person[s] with a legal right to pursue eviction or possessory action” are prohibited from evicting covered persons during the order period.

Covered persons are tenants, lessees, or other residents who assert five specified conditions under the CDC order. The CDC order does not relieve any individual of their rent or housing responsibilities.

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4 See Notice by the Centers for Disease Control and Prevention, *Temporary Halt in Residential Evictions to Prevent the Further Spread of COVID-19.*
payment obligation, and also does not preclude the charging or collecting of fees, penalties or interest from the covered person due under the terms of any applicable contract.

In this Hot Topic, we address the primary accounting and reporting impacts of the above-outlined provisions of the CARES Act and the CAA on companies reporting under US GAAP as we currently understand them.

**Applicability**

This Hot Topic is intended to address key impacts to companies that report under US GAAP. It does not consider the effects of the CARES Act or the CAA on companies that report under IFRS or other GAAP; states, municipalities and other entities that report under GASB or FASAB standards; or individuals.

**Key impacts**

The following are key impacts and considerations stemming from the principal provisions of the CARES Act and the CAA affecting companies applying US GAAP.

— **Income taxes.** Companies should recognize the effects of a tax law change on deferred tax assets and liabilities (including changes in the valuation allowance) in income in the interim period that includes the enactment date – e.g. March 27, 2020 for the CARES Act and December 27, 2020 for the CAA.

— **Employee retention credit (ERC) and payroll taxes.** Companies electing to defer payroll tax remittances will need to accrue an appropriate payroll tax liability and recognize related payroll tax expense in the period it is incurred. Companies intending to take the ERC offered under the CARES Act generally should recognize the credit consistent with other government grants.

— **Government grants.** Companies and not-for-profit entities receiving government grants as a result of the CARES Act and/or the CAA will need to determine the appropriate guidance to apply to account for them.

  - Not-for-profit entities account for non-exchange transactions under Subtopic 958-605 (not-for-profit entities—revenue recognition), and exchange transactions under Topic 606 (revenue from contracts with customers).

  - Companies that are for-profit entities apply Topic 606 if the consideration represents a payment for goods or services provided by the company (ordinary activities of the company). If the government is not a customer, or is not paying on behalf of a customer, US GAAP does not provide explicit guidance and there are multiple approaches that are applied in practice. Those include analogizing to Topic 606, analogizing to IAS 20 (government grants) or Subtopic 958-605, or applying contingent gain accounting.

  - Companies may account for a PPP loan obtained by applying debt accounting under Topic 470 (debt). Alternatively, because the loan may also be viewed as an in-substance government grant, companies may apply grant accounting to the loan if they expect to meet the conditions for loan forgiveness.
Because the CAA expands the types of expenses eligible for PPP loan forgiveness, an entity’s expectation of meeting the conditions for loan forgiveness may change.

— **Debt/equity instruments issued to government agencies.** The specific terms of the (1) loans companies will obtain from the government and (2) warrants or other equity instruments they may issue to the government may not be standardized for all industries. Companies will need to carefully consider the appropriate debt and equity guidance in US GAAP based on the specific terms.

There are significant restrictions imposed on companies that obtain loans from the government under the CARES Act; companies generally will need to evaluate the effect of those new restrictions on their other existing contractual agreements.

— **CECL deferral and troubled debt restructurings (TDRs).** The CARES Act and the CAA provide for financial institutions and insurance companies to suspend application of the TDR guidance in Topic 310. Insured depository institutions, bank holding companies and affiliates of either can elect to defer applying Topic 326. The SEC’s chief accountant issued a statement that financial statements prepared in accordance with either of these elections would be considered to be prepared in accordance with US GAAP.

— **Mortgage relief.** Lenders accounting for borrower forbearance requests will generally need to adjust their interest income recognition for the modified loan terms, while those federally mandated modifications or deferrals will not be considered TDRs.

— **Lease eviction moratorium.** The eviction moratorium on its own may not trigger any accounting for affected lessors. However, other changes to a lease contract enacted as a result of the moratorium may trigger modification accounting. And regardless of whether a lease modification results, lessors may have to revise their lease accounting for tenants they cannot evict if it is not probable those tenants will ultimately be able to pay substantially all of their rent under the lease.

— **Timing of recognition.** The CARES Act and the CAA are current reporting period events for annual and interim periods that include March 27, 2020 and December 27, 2020. However, companies will need to monitor for additional government actions that occur after the end of the reporting period that includes the date the applicable relief bill was signed – e.g. clarification of certain requirements and processes – and evaluate whether those subsequent events should be recognized and/or disclosed.

**Detailed contents**

This Hot Topic is divided into the following sections:

— Income taxes
— Employee retention credit and payroll taxes
— Paycheck protection program
— Government grants and payments for goods and services
— Debt and equity instruments issued
— Deferral of CECL and suspension of TDR guidance
— Mortgage relief
— Lease eviction moratoriums
— Subsequent events and going concern
Recognizing the change in tax law

Companies should recognize the effect of the change in tax law on existing deferred tax assets and liabilities in income from continuing operations in the interim period that includes the enactment date (March 27, 2020 for the CARES Act and December 27, 2020 for the CAA). This includes any changes in a company’s valuation allowance that is attributable to the tax law change. [740-270-25-6, 30-11]

The CARES Act and many of the COVID-19 related tax law changes in the CAA are retroactive. As a result, the estimated annual effective tax rate for the current period and income taxes payable or receivable for a prior annual period are adjusted in the interim period that includes the enactment dates of those changes. [740-270-25-5 – 25-6]

Other income tax changes in the CAA are effective either immediately or in future interim reporting periods (e.g. deductibility of business meals is effective January 1, 2021, see below) for some companies. How the effects of the tax law changes effective in future interim periods are reflected in the estimated annual effective tax rate depends on whether a company has adopted ASU 2019-12. If it has not, the effects are reflected in the estimated annual effective tax rate in the later of the interim period that includes the enactment date or the effective date. If a company has adopted ASU 2019-12, it reflects the effects in the estimated annual effective tax rate in the interim period that includes the enactment date. [740-270-25-5 – 25-6, 55-49]

We believe a company has two options for determining the amount of the remeasurement of its deferred tax assets and liabilities to recognize discretely.

**Enactment date approach**

— **Step 1**: Remeasure enactment date deferred tax assets and liabilities and recognize the adjustment as a discrete item in the interim period that includes the enactment date.

— **Step 2**: Adjust the estimated annual effective tax rate and apply it to year-to-date ordinary income to arrive at year-to-date income tax expense. From this amount, exclude the amount computed in Step 1 and recognize the remainder.

**Beginning-of-year approach**

— **Step 1**: Remeasure beginning-of-year deferred tax assets and liabilities and recognize the adjustment as a discrete item in the interim period that includes the enactment date.

— **Step 2**: Adjust the estimated annual effective tax rate and apply it to year-to-date ordinary income to arrive at year-to-date income tax expense. Recognize this amount.

A company should consistently apply its method and disclose the total enactment date effect on deferred taxes resulting from the change in tax law. [740-10-50-9(g)]

As a reminder, SAB 118 (income tax accounting implications of the Tax Cuts and Jobs Act) applied only to the application of Topic 740 to the Tax Cuts and Jobs Act (TCJA). We are not aware of an effort by the SEC staff to extend the guidance to the changes resulting from the Act, the CAA or any other legislation.

Like any new tax law, regulations that change, clarify or interpret the law may be issued in the future. IRS regulations generally are recognized entirely in the period in which they are issued. This is true because they: [740-270-25-6, 740-10-25-6, 35-2]

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— change enacted tax law and therefore are accounted for under Topic 740’s guidance on changes in tax law; or
— clarify or interpret the law and therefore are accounted for under Topic 740’s guidance on income tax uncertainties, which allows companies to consider only information that is available at period-end when evaluating recognition and measurement of income tax amounts.

However, because a company is required to consider all available evidence when evaluating the need for a valuation allowance, interpretive guidance issued after the period-end date may need to be considered in that analysis. [740-10-30-17]

Sections 5 and 10 of KPMG Handbook, Accounting for income taxes, discuss changes in tax laws in interim periods in additional detail.

Net operating losses

The Act allows a five-year carryback of net operating losses (NOLs) arising in tax years beginning after December 31, 2017 and before January 1, 2021. The Act also allows full carryback for these NOLs. As a result, a company:
— can offset all of its taxable income with these NOLs – it is not limited to offsetting 80% of its taxable income; and
— will generally realize a 35% benefit from these NOLs if it carries them back to a tax year in which 35% was the enacted tax rate. Off-calendar year-end taxpayers also realize a benefit higher than 21% if they carry the NOLs back to a tax year in which the enacted rate was 35% or a blended rate applied to the tax year.

The Act also allows an off-calendar year-end taxpayer to carry back 2 years but restricts the carryforward to 20 years for NOLs that arose in the tax year that straddled December 31, 2017. This change corrected an apparent error in the TCJA, which was enacted in December 2017.

A valuation allowance is required for deferred tax assets if it is more likely than not that all or some of the assets will not be realized. In assessing realization, a company considers whether it will be able to generate sufficient taxable income in the period and of the character (e.g. ordinary, capital, foreign source) necessary to use the benefit. [740-10-30-16 – 30-25]

If a company applies the carryback provisions, it:
— converts to income tax receivables the deferred tax assets related to those NOLs; and
— reduces the total amount of existing deferred tax assets.

Although Topic 740 does not require a company to prepare a detailed schedule of the reversal of its temporary differences, it may need to schedule to determine how much of the new total of deferred tax assets are more likely than not to be realized – i.e. after the total has been reduced by the carryback amount. Further, off-calendar year-end taxpayers may be able to conclude that deferred tax assets scheduled to reverse in tax years beginning before January 1, 2021 are more likely than not to be realized because they also will be available for carryback. [740-10-30-18, 55-15]

Section 4 of KPMG Handbook, Accounting for income taxes, discusses valuation allowances in additional detail.

Interest deductibility

Current US federal tax law allows taxpayers to deduct interest expense only to the extent that it does not exceed 30% of adjusted taxable income for the respective tax year. The Act temporarily increases the deductibility of interest expense from 30% to 50% of adjusted taxable income for tax years beginning in 2019 and 2020.

Increasing the deductibility of interest expense may provide immediate benefit to companies by increasing a net operating loss in the 2019 or 2020 tax years (which can be carried back up to 5 years).
or reducing the tax liability for these years. It also results in a decrease in a company’s deferred tax assets related to disallowed interest carryforwards. Like the changes related to NOLs discussed above, this change in total deferred tax assets may require companies to schedule the reversals of their deferred tax assets and liabilities to determine how much of the deferred tax assets are more likely than not to be realized. [740-10-30-18, 55-15]

Section 4 of KPMG Handbook, Accounting for income taxes, discusses valuation allowances, including considerations specific to interest deductibility, in additional detail.

**Alternative minimum tax**

The alternative minimum tax (AMT) regime was repealed in 2017 under the TCJA. For 2018, 2019 and 2020, existing AMT credit carryforwards were used to reduce a company’s regular tax obligation. Any remainder was eligible for a 50% refund in 2018–2020 and a 100% refund in 2021. For example, 50% of an AMT credit carryforward that was unused in the 2019 tax year (i.e. did not offset regular taxable income in that year) was refundable and the other 50% becomes refundable in 2020 and 2021. The Act accelerates the refunds to the 2019 tax year for remaining AMT credit carryforwards.

Companies currently classify AMT credit carryforwards as either income tax receivables or deferred tax assets. We believe existing deferred tax assets related to the carryforwards now should be classified as income taxes receivable because they will reduce income taxes payable or be refunded.

Sections 3 and 9 of KPMG Handbook, Accounting for income taxes, discuss the repeal of the US AMT system in 2017 and the presentation of AMT credit carryforwards in additional detail.

**Tax accounting method changes**

The Act may change the tax accounting methods that are permissible to be used, or may change the tax accounting methods a company chooses to use, resulting in a company committing to change its tax accounting method. For example, taxpayers are required to change the depreciation methods of qualified improvement property placed in service after 2017 if it has been depreciated as 39-year building property. Taxpayers should generally be able to change the depreciation methods by filing an automatic accounting method change, or an amended tax return if the property was depreciated in only one prior tax return.

A company generally demonstrates its commitment to making a change in a tax accounting method by preparing and submitting Form 3115 before the period-end financial statements are issued (available to be issued). However, all facts and circumstances should be considered. In addition, if the change is a non-automatic change, we would expect the change to be more likely than not to be sustained.

**PPP loan forgiveness and other grants**

All or a portion of a PPP loan (first or second draws) may be forgiven (see PPP discussion in the background section). Such forgiveness is not included in the borrower’s gross taxable income.

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Under the CAA, a borrower may deduct otherwise deductible expenses that are paid with the proceeds of a PPP loan, even if that loan is forgiven. In addition, PPP loan forgiveness does not reduce the tax bases or other attributes of the borrower’s assets. This provision is retroactive to the CARES Act enactment date (March 27, 2020).

The IRS had previously released guidance that such expenses were not deductible. Borrowers that have been applying that guidance should account for the change made by the CAA in the interim period that includes the CAA enactment date (December 27, 2020).
The CAA also clarifies that:

— Gross taxable income does not include other (non-PPP) loan forgiveness, emergency EIDL grants or loan repayment assistance provided by the CARES Act and borrowers may deduct otherwise allowable expenses paid with the proceeds. These provisions are effective for tax years ending after the CARES Act enactment date.

— The provisions in the preceding bullet also apply to Targeted EIDL advances and Grants for Shuttered Venue Operators, effective for tax years ending after the CAA enactment date.

Other CAA income tax changes

In addition to COVID-19 related relief, the CAA extends (or makes permanent) several temporary tax measures and introduces some new ones. Companies should recognize any effect of these changes on existing deferred tax assets and liabilities in income from continuing operations in the interim period that includes December 27, 2020. This includes any change in a company’s valuation allowance that is attributable to the tax law change. [740-270-25-5, 30-11]

Temporary provisions that have been made permanent include the deduction for energy efficient commercial buildings and the railroad track maintenance credit. Those that have been extended include:

— the look-thru rule for related controlled foreign corporations (which excludes from taxable income certain amounts accrued or received from such entities);
— the new markets tax credit;
— the employer tax credit for paid family and medical leave;
— empowerment zone incentives; and
— the energy credit.

Among other things, the CAA also:

— modifies the low-income housing tax credit rate;
— allows for the use of 30-year ADS depreciation for certain residential real property placed in service before January 1, 2018;
— expands and extends the availability of the energy credit;
— allows a full deduction for business meal expenses incurred and paid from January 1, 2021 through December 31, 2022; and
— provides tax relief, including employee retention credits and increases in low-income housing tax credit allocations, to states in the event of a disaster other than COVID-19.

Other resources


KPMG Coronavirus (COVID-19) tax developments website provides additional resources on legislative matters in response to COVID-19 and our Year-end funding and COVID relief legislation website provides an overview of CAA.
Employee retention credit and payroll taxes

Payroll tax deferral

The CARES Act’s payroll tax deferral provision permits employers to defer payment of the 6.2% employer share of Social Security payroll taxes they otherwise would be responsible for paying in 2020, effective for such payments due after the date the Act was signed into law. Fifty percent of the deferred payroll taxes are due on December 31, 2021, and the remaining amounts are due on December 31, 2022. However, taxpayers following the recurring item exception are generally only allowed to deduct accrued payroll taxes that are paid no later than 8½ months after year end; amounts paid after this date are deductible when paid. Accordingly, calendar year-end taxpayers that are eligible to carryback a loss to a year with a 35% tax rate may want to consider making full payment of 2020 payroll taxes no later than September 15, 2021.

While the Act will permit deferring the required payment to the government to assist entities with current year cash flow needs, the employer share of Social Security payroll taxes should be recognized as expense by companies when the services are provided to them by the related employees (i.e. as incurred). This will result in the recognition of a payroll tax liability during the deferral period until the payroll taxes are ultimately paid to the government. In addition, discounting the payroll tax liability may be appropriate depending on when the employer determines its deferred payroll taxes are due, and if the carryback eligibility applies.

Employee retention credit

See Background for details about the ERC.

The ERC is first claimed against an employer’s payroll taxes. If the aggregate credit exceeds the company’s payroll taxes, the excess is refundable to the company.

For companies that have applied for the ERC, recognition of a receivable related to the ERC should be at the time it is earned by the company. The guidance on the accounting for government grants (see Government grants section of this Hot Topic) should be considered to assist in determining when the ERC is earned by the company and how to present the related income in the financial statements.

KPMG Hot Topic, Compensation and benefit arrangements and related accounting implications, provides additional guidance on the potential accounting effects of COVID-19 on compensation and benefits.

Paycheck protection program

Lender considerations

The Small Business Administration (SBA) provides a 100% guarantee of loans issued as part of the PPP subject to specific limitations. If the loan is sold to another party, the guarantee transfers with the loan. We believe that the guarantee is not considered a freestanding contract because it is not (1) legally detachable from the loan and (2) separately exercisable. Since the guarantee is not a freestanding contract, the lender considers the SBA guarantee when estimating the allowance for expected credit losses.

The entire principal amount and any accrued interest is eligible for forgiveness if the proceeds are used by the borrower to make eligible payments for a period of time after the loan was made. We believe any amounts received by the lender from the SBA prior to the contractual maturity of the loan would be treated as a prepayment thereof.
The lender receives a processing fee from the SBA that ranges from 1% to 5% based on the principal amount of the loan. In addition, the lender incurs direct loan origination costs. We believe the net amount of such fees and costs would generally be deferred and amortized over the contractual maturity of the loan in accordance with Subtopic 310-20 (financial instruments—nonrefundable fees and other costs). However, if the lender holds a large number of similar loans for which prepayments are probable and the timing and amount of prepayments can be reasonably estimated, the lender would be permitted to include estimates of prepayments in determining the constant effective yield.

The lender should also evaluate whether a contingent liability should be recognized in accordance with Topic 450 (contingencies) for any non-credit losses expected from participating in the PPP.

The PPP loans can be sold to parties other than the SBA. If the lender has the intent to sell the loan to an entity other than the SBA, it should be classified as held-for-sale.

**Borrower considerations**

The nature and intent of the PPP raises questions about whether the proceeds from a loan obtained under the program should be accounted for as debt or as a government grant. A loan obtained through the PPP is, in legal form, debt and therefore it is acceptable to apply debt accounting under Topic 470. If a company expects that the requirements for loan forgiveness will be met, we believe it is also acceptable to treat the loan as an in-substance government grant. This view is consistent with the guidance in the AICPA Technical Q&A Section 3200.

**Debt accounting**

A company records the proceeds as debt. The debt is subsequently measured at amortized cost, using the effective interest method under Topic 835 (interest) to recognize interest expense, unless the company elects to measure it at fair value with changes thereto reported in earnings. Subtopic 835-30 (imputation of interest), which requires imputation of interest on certain low-interest or interest free loans, does not apply to transactions with interest rates affected by tax attributes or legal restrictions prescribed by a government agency (e.g. government-guaranteed obligations). Because the government guarantees and sets the terms for the PPP loans (e.g. 1% interest rate), a company should not impute interest at a market rate on a loan under this program. [835-30-15-3(e)]

If the loan or part of the loan is subsequently forgiven, the company recognizes the income as a gain on extinguishment of debt when it is legally released from its obligation based on the application of the guidance in Subtopic 405-20 (extinguishments of liabilities). We believe the company is legally released from being the primary obligor under the liability on notification of forgiveness from the lender (see Loan forgiveness section below).

**Grant accounting**

A company may account for the forgivable loan as a grant if the company expects to comply with the requirements for loan forgiveness (i.e. the loan is an in-substance government grant). Therefore, the company must be able to assert that (1) it is eligible for the funds (see background discussion) and (2) it has the ability and intent to meet the loan forgiveness conditions.

Not-for-profit entities apply the guidance in Subtopic 958-605 to government grants. Revenue is recorded based on whether the conditions for forgiveness are substantially met, not on whether they are likely to be met. The requirement to spend the PPP proceeds on certain qualifying expenses imposes a limited discretion barrier to entitlement of forgiveness, which requires the not-for-profit entity to account for the forgivable loan as a conditional contribution. The grant becomes unconditional and is recognized as revenue to the extent that qualifying expenses are incurred. See discussion of grant accounting for not-for-profit entities in ‘Government grants and payments for goods and services’ below.

There is no grant accounting guidance in US GAAP that explicitly applies to for-profit companies. Therefore, those companies will need to analogize to guidance to account for the government grant.
(i.e. the loan proceeds expected to be forgiven). A company applying grant accounting reevaluates its expectations for forgiveness at each reporting period and may need to reverse income if previously recognized.

IAS 20 provides a grant accounting framework for forgivable loans if there is reasonable assurance (which we understand the SEC staff equates to probable under US GAAP) that the company will meet the terms for forgiveness of the loan. For-profit companies may analogize to IAS 20 but must evaluate how the proceeds are or will be used and their workforce and compensation levels when determining whether or what portion of the loan is probable of forgiveness.

For-profit companies may also analogize to Subtopic 958-605 (not-for-profit grants) or Topic 450 (contingent gains) to account for an in-substance grant. See Government grants and payments for goods and services section below.

Because the CAA expands the types of expenses eligible for PPP loan forgiveness, a company’s expectation of meeting the conditions for loan forgiveness may change.

**Loan forgiveness**

To receive loan forgiveness under the PPP, a company completes the loan forgiveness application and submits the required documentation to its lender, who within 60 days issues a decision to the SBA on full or partial loan forgiveness. The SBA will remit the amount forgiven plus accrued interest to the lender within 90 days of receipt of notice from the lender. The lender then notifies the company of the loan forgiveness.

The SBA has six years to audit the company’s good faith certification of eligibility and the appropriateness of the expenditures. A company should have robust processes, procedures and controls in place to document its eligibility and ensure the expenses incurred under the loan program meet the eligibility requirements. Subsequent to submission and notification of loan forgiveness, if the company were to determine certain expenses were not eligible, the company would follow Subtopic 450-20 (loss contingencies) and record a liability for the amount subject to repayment.

**Government grants and payments for goods and services**

The Act provides direct government assistance through new and repurposed existing programs. These programs target a variety of companies including air carriers (passenger and cargo), airport operators, health care providers, higher education institutions and agricultural producers. The assistance may comprise varying forms of support, including payroll and payroll tax support, and reimbursement of healthcare-related expenses and/or lost revenue.

In addition, certain loan programs provided pursuant to the Act may contain favorable rates of interest relative to what may be considered a market cost of funds. Financial institutions generally did not separate a grant element for the favorable loan terms they received under the Troubled Asset Relief Program (TARP) established in response to the 2008 financial crisis. In the absence of US GAAP in this area, that may be a relevant precedent when considering how to account for any loans obtained under the Act that ultimately have below-market terms. Not recognizing a separate grant element may also be conceptually consistent with not imputing interest on low-interest or interest free loans from a government. [835-30-15-3(e)]

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6 ‘Probable’, as defined in US GAAP, means ‘the future event or events are likely to occur’.
7 International Accounting Standard No. 20 Accounting for Government Grants and Disclosure of Government Assistance.
The accounting for government grants by companies applying US GAAP may differ based on:

— whether any amounts received represent consideration from a contract with a customer in the scope of Topic 606 (revenue from contracts with customers); or
— if the amounts received do not represent consideration from a contract with a customer:
  — whether the entity is a not-for-profit entity and subject to the specific accounting guidance in Subtopic 958-605 (not-for-profit entities—revenue recognition); and/or
  — the accounting policy election a for-profit company has made to analogize to other guidance.

Not-for-profit entities

Subtopic 958-605, as amended by ASU 2018-08, stipulates that an exchange transaction is a reciprocal transaction where each party receives and sacrifices commensurate value, and that the public benefit of a government grant or the execution of the grantor’s mission do not represent commensurate value.8 After the amendments in ASU 2018-08, more transactions are considered contributions, accounted for under Subtopic 958-605, than were previously. Entities should carefully evaluate the provisions of the Act to determine whether consideration received represents a contribution or an exchange transaction that should be accounted for under Topic 606 (see Topic 606 discussion below).

Revenue from conditional contributions is recognized when the conditions on which the contribution depends are substantially met. Contributions are considered conditional if:

— there is a right of return to the contributor for the transferred assets (or reduced, settled or cancelled liabilities), or a right of release of the promisor from its obligation to transfer assets (or reduce, settle or cancel liabilities); and
— one or more barriers must be overcome before the recipient is entitled to the resources transferred or promised.

Subtopic 958-605 provides a list of indicators that an agreement contains a barrier that must be overcome for the recipient to be entitled to the resources. Some agreements may contain multiple barriers that must be overcome before the entity is entitled to the contribution. Although trivial stipulations (e.g. a requirement to provide an annual report) are not considered barriers to entitlement, the ease with which a barrier may be met, or the entity’s historical experience with meeting the barrier, are not factors to consider when determining whether the contribution is conditional. Revenue is recorded based on whether the condition is substantially met, not on whether it is likely to be met.

For-profit business entities*

US GAAP provides limited guidance on the accounting for government grants. Subtopic 905-605 provides guidance on the accounting for agricultural subsidies and Subtopic 958-605 provides guidance on government grants to not-for-profit entities. The lack of guidance on the accounting for government grants by for-profit businesses has historically resulted in diversity in practice. We expect diversity will continue to exist.

Companies should consider first whether specific industry guidance applies to the consideration to be received – e.g. Subtopic 905-605 for agricultural subsidies. Next, it is important to assess whether either the government or another party in the transaction is a customer, such that the consideration to be received is actually a payment for a good or service. In this case, Topic 606 applies (see further discussion below). A customer is a party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration. [Topic 606 Glossary]

For example, a healthcare entity accounts for funds it receives from a government agency on behalf of a patient to whom it provides services, by applying the guidance in Topic 606. Although the patient is

8 ASU No. 2018-08, Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made.
the customer under Topic 606, the payments the government makes on the patient’s behalf are considered payments for the services provided to the patient. Government mandates or Medicare/Medicaid changes that include rate adjustments to, or provide enhanced coverage for, services the entity provides to patients would be accounted for under Topic 606.

Companies should carefully evaluate the relevant provisions of the Act to determine whether the consideration they will receive is in scope of Topic 606. Companies may conclude some provisions of the Act are in the scope of Topic 606, while others are not.

If the grant consideration is not in the scope of specific guidance, including Topic 606, a company should consider the nature of the grant and its historical accounting policies and practices when determining appropriate guidance to apply by analogy. Some of the analogies that we are aware are applied in practice are discussed below.

Companies that have not previously received government grants may need to develop new accounting policies and procedures, and significant judgment may be required to account for newly implemented government programs such as those arising from the Act.

**Topic 606, Revenue from Contracts with Customers**

Some companies analogize to Topic 606 even when the consideration they will receive is not in its scope. If a company applies Topic 606 only by analogy, it does not classify the subsidy as revenue from contracts with customers.

Accounting for grants by analogizing to Topic 606 would include, among other things:

— evaluating when the company has enforceable rights and obligations;
— determining whether the consideration is variable; and
— if there is variable consideration, determining the appropriate amount to recognize in the income statement after consideration of the constraint on variable consideration.

When analogizing to Topic 606, judgment will likely be necessary to determine the hypothetical measure of progress over which to recognize income, assuming over time recognition is appropriate, since no good or service is being transferred to the government. The nature of the grant is considered when determining whether Topic 606 provides appropriate analogous guidance. While Topic 606 could provide appropriate analogous guidance to account for some grants, the types of grants in the CARES Act and the CAA are generally accounted for by following one of the accounting analogies below.


**IAS 20, Accounting for Government Grants and Disclosure of Government Assistance**

Some for-profit companies account for grants by analogizing to IAS 20.

Under IAS 20, grants are defined broadly and a company does not recognize a government grant until it has reasonable assurance that (1) it will comply with the relevant conditions and (2) the grant will be received. Judgment may be required, particularly if the grant program’s requirements are unclear or require additional regulatory interpretation, or where there is little established practice for assessing whether the company will meet the conditions to receive the grant.

If conditions (1) and (2) are met, the company recognizes the grant in profit or loss on a systematic basis in line with its recognition of the expenses that the grants are intended to compensate. Companies need to carefully consider the conditions associated with the grant to determine whether it compensates for expenses already incurred or future costs. For example, manufacturers may need to consider whether a grant relates to payroll costs capitalized in inventory and if so, the grant income is recognized when the payroll expense is recognized in future periods.

The measurement and presentation of government grants depends on the nature of the grant and the company’s accounting policies.
— For grants related to assets, a company can elect to either:
  - deduct the grant from the cost of the asset (net presentation); or
  - present the grant separately as deferred income to be amortized over the useful life of the asset (gross presentation).
— For grants related to income, a company can elect to either:
  - offset the grant against the related expenditure; or
  - include it in other income.

Under IAS 20, a forgivable loan is a government grant when there is reasonable assurance that the company will meet the terms for forgiveness of the loan. In the absence of specific US GAAP guidance applicable to for-profit companies, it is acceptable for those companies to analogize to IAS 20 to account for forgivable loans, provided it is probable that the conditions for forgiveness of the loan will be met. See the borrower considerations in the ‘Paycheck protection program’ section for additional discussion of PPP loans.

Companies may need to reassess their grant recognition based on changes to various programs under the CAA (e.g. PPP, ERC). Companies that received PPP funds under the CARES Act that have not yet been forgiven will need to consider whether the CAA’s expansion of expenses eligible for forgiveness results in more grant income attributable to expenses incurred in prior periods.

See section 4.3 of KPMG publication, Insights into IFRS, or IFRS Perspectives article for additional guidance on the accounting for government grants under IAS 20.

**Subtopic 958-605, not-for-profit entities – revenue recognition**

Other for-profit companies analogize to Subtopic 958-605 (see discussion above under not-for-profit entities section). The guidance on contributions in Subtopic 958-605 excludes transfers of assets from governmental entities to business entities. However, the FASB staff have noted that business entities are not prohibited from analogizing to that guidance.

Revenue from conditional contributions is recognized under Subtopic 958-605 when the conditions on which the contribution depends are substantially met. Importantly, ASU 2018-08 eliminated the assessment of ‘remote’ as a separate step when determining whether a contribution is conditional. Therefore, a company cannot factor in the likelihood that a barrier will be overcome. Generally, we believe it would not be appropriate for a for-profit entity that is analogizing to Subtopic 958-605 to present grant income as revenue because the income is not earned as a result of a revenue generating activity. Rather, the grant would be presented as income.

See additional discussion on the accounting under Subtopic 958-605 in the not-for-profit entities section above.

**Topic 450, Contingencies**

Some companies have historically applied gain contingency accounting under Topic 450. Under this approach, a company does not recognize income related to the grant consideration until it is realized or realizable.

**Presentation and disclosure impacts**

Companies (and not-for-profit entities) should consider the guidance from the relevant grant accounting model when determining the appropriate presentation of grant income in the income statement.

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9 ‘Probable’ in this context means as the term is defined in US GAAP, meaning ‘the future event or events are likely to occur’.
10 April 17, 2020 meeting of the FASB’s Private Company Council.
The accounting treatment, together with the nature of the grant, may also inform the appropriate classification of the grant proceeds in the statement of cash flows. Generally, we believe that grant proceeds received under the CARES Act or the CAA to defray operating costs, supplement sales proceeds or maintain employment should be classified as cash flows from operating activities when they are accounted for as a grant – e.g. by analogy to IAS 20 – because the company expects to meet the PPP forgiveness criteria. Companies that elect to account for a PPP loan under Topic 470 should consistently classify the funds as cash flows from financing activities.

Companies need to evaluate whether grant proceeds received should be presented on the balance sheet as restricted cash until spent, based on the terms of the grant and their accounting policy. Unfulfilled grant conditions do not necessarily indicate the cash is restricted. When cash is restricted in use, the nature of the restrictions should be disclosed. [230-10-50-7]

The only disclosures US GAAP requires for government assistance are in Topic 740 (for assistance in the form of income tax credits), Topic 470 (for assistance in the form of loans), and Subtopic 958-605 (for assistance provided to a not-for-profit entity). However, we believe companies and not-for-profit entities should consider disclosing the following information in relation to grants received under the CARES Act or the CAA:

- nature of the program;
- amount received;
- form of the grant;
- significant terms and grant conditions, including those that are unfulfilled at the reporting date;
- accounting policy elections, including presentation approach; and
- financial statement line items affected by the grant.

### Debt and equity instruments issued

While the specific terms of the loans, loan guarantees and other investments (e.g. warrants, other equity interests, senior debt securities) authorized by the Act (see the ISLP and LPLB discussions in the background section) may not be the same for every company, the considerations summarized below generally apply when accounting for any debt or equity instruments.11

Loans under these programs will generally impose significant restrictions on the issuers (see background section). Depending on the program, some of the restrictions remain after the issuer has repaid the loan or the loan guarantee has ended. An issuer should consider the potential effect of these restrictions on its other arrangements, such as whether a restriction stemming from the government loan would affect its ability to perform under an existing arrangement and, if so, the related accounting implications (e.g. how to account for early termination of the other agreement).

Other sections of the Act also authorize programs involving issuance of debt and equity instruments (e.g. the Paycheck Protection Program and the Pandemic Relief for Aviation Workers program – see background section). Additional considerations may apply under those programs. See also Paycheck protection program and Government grants and payments for good and services.

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11 The Treasury Department has published preliminary procedures and minimum requirements for loans to passenger and cargo air carriers and eligible businesses and businesses critical to maintaining national security that have experienced losses as a result of coronavirus. Those procedures require each borrower to identify the financial instruments it proposes to issue to the Treasury Department. The Treasury Department will issue supplemental procedures, including loan terms and conditions.
## Classification of debt and equity instruments

A debt instrument is classified as a liability. When financial instruments have attributes of both equity and debt (e.g. warrants, options, redeemable preferred stock), they may be classified as liabilities or equity, depending on their terms. Further, all debt and equity instruments may include embedded derivatives that require separate accounting as an asset or liability. The following table summarizes an issuer’s considerations when determining how to classify a financial instrument.

<table>
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<tr>
<th>Guidance</th>
<th>Key considerations</th>
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| **Distinguishing liabilities from equity (Topic 480)** | Topic 480 requires the following three classes of freestanding financial instruments to be classified as liabilities if certain conditions are met. Some instruments in the scope of Topic 480 are required to be subsequently measured at fair value with changes thereto reported in earnings.  
**Mandatory redeemable financial instruments.** An example of an instrument that may be in this class is preferred stock that is redeemable on a specified or determinable date.  
**Financial instruments that embody obligations to repurchase the issuer’s equity shares.** An example of an instrument that may be in this class is a puttable warrant (including a warrant that is exercisable into an equity share that is redeemable at the option of the investor) that the issuer may be required to pay cash to settle.  
**Financial instruments that embody obligations settled by issuing a variable number of equity shares.** An example of an instrument that may be in this class is a debt arrangement that requires the issuer to settle the obligation by issuing a variable number of shares having a value equal to the principal amount. |
| **Instruments indexed to and settled in an issuer’s own stock (Subtopic 815-40)** | Freestanding instruments (e.g. warrants) that do not meet the following requirements are required to be reported as liabilities. Generally, they are subsequently measured at fair value, with changes thereto reported in earnings.  
**Indexed to the issuer’s own stock:** For an instrument to meet this requirement, it generally must be indexed only to the issuer’s own stock. Indexation means that the value of the instrument varies with changes in the value of the underlying.  
**Settled in the issuer’s own stock:** For an instrument to meet this requirement, it generally needs to permit or require the issuer to settle in unregistered shares. Instruments that an issuer may be required to settle in cash (e.g. at the option of the investor) generally do not meet this requirement. In addition, embedded derivatives (e.g. conversion features embedded in a debt instrument) that meet these conditions do not require separate accounting. |
| **Embedded derivatives (Subtopic 815-15)** | When a financial instrument is not subsequently measured at fair value with changes in fair value reported in earnings, the issuer determines whether any embedded features require separation (e.g. an option to convert debt into common shares). Embedded features are only separated if they meet all of the following conditions:  
The embedded feature is not clearly and closely related to the host contract.  
A freestanding instrument with the same terms as the embedded feature would meet the definition of a derivative instrument (i.e. it has an underlying; a notional and/or payment provision; no or small initial net investment; and is net settleable.  
The embedded derivative is not excluded from derivative accounting. For equity-linked features, the most common such exclusion applies when the feature is indexed to and settled in the issuer’s own stock. |

Additional considerations apply when the conversion option in a convertible instrument is not separately accounted for as an embedded derivative. Further, SEC registrants (and non-SEC registrants that elect to follow similar accounting guidance) may be required to classify redeemable instruments as temporary – rather than permanent – equity.
Initial recognition – allocation of proceeds

When debt is issued with no other instruments, it is ordinarily recorded at the proceeds received. When debt is issued together with other debt or equity instruments, how proceeds are allocated depends on the classification and subsequent measurement of those other instruments. Considerations for allocating proceeds are summarized in the following decision tree.

- **Are any instruments measured at fair value?**
  - Yes
    - **Is there more than one instrument that is not measured at fair value?**
      - Yes
        - Allocate fair value to instruments measured at fair value and allocate remaining proceeds to other instruments on a relative fair value basis
      - No
        - Allocate fair value to instruments measured at fair value and allocate residual to remaining instrument
  - No
    - Allocate proceeds on a relative fair value basis

Fair value is ‘the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.’ Estimating a financial instrument’s fair value may be complex, particularly during an economic downturn, when there is a significant decrease in the volume or level of activity in the market for an item compared with its normal market activity. For additional guidance on fair value measurement, including orderly transactions and inactive markets, see KPMG Handbook, Fair value measurement. [Topic 820 Glossary]

Subsequent measurement

- **Debt instruments**: Certain debt instruments in the scope of Topic 480 are required to be subsequently measured at fair value with changes in fair value reported in earnings. Other debt instruments generally are subsequently measured at amortized cost, using the effective interest method under Topic 835 (interest) to recognize interest expense, unless the issuer elects to measure it at fair value with changes thereto reported in earnings.

- **Equity instruments**: An equity instrument that is classified in equity generally is not remeasured after initial recognition. An instrument whose legal form is equity, but that is liability-classified, generally is subsequently measured at fair value with changes thereto recorded in earnings, unless it is a mandatorily redeemable instrument under Topic 480.

Earnings per share considerations

A company that presents earnings per share (EPS) also must consider whether and how debt and equity instruments issued under one of the Act’s programs might impact their EPS computations. For example:

- dividends on preferred stock reduce net income available to common shareholders;
- warrants to purchase common stock are included in EPS calculations using the treasury stock method; and
- convertible debt instruments are included in EPS calculations using the if-converted or the treasury stock method, depending on the issuer’s settlement options.

A company also considers whether any instruments issued represent participating securities resulting in a requirement to use the EPS two-class method.
Deferral of CECL and suspension of TDR guidance

The CARES Act, as amended by the CAA, includes an elective deferral of Topic 326 (the ‘credit losses standard’) and an elective suspension of applicable US GAAP for certain loan modifications. On enactment, there were questions about whether financial statements prepared in accordance with either of these elections would be considered to be prepared in accordance with US GAAP. In response, on April 3, 2020, the SEC’s Chief Accountant stated that the SEC staff would not object to the conclusion that financial statements prepared subject to one or both of these elections for the periods for which such elections are available are in accordance with US GAAP.

Credit losses standard

The CARES Act permitted insured depository institutions, bank holding companies or any affiliate to temporarily defer applying the credit losses standard. The deferral provided by the CARES Act applied from the date the Act was signed into law (March 27, 2020) to the earlier of:

— the date the COVID-19 national emergency comes to an end; and

After the CARES Act’s enactment, the SEC staff clarified the following matters with respect to the deferral.

— Only those companies that are specifically identified (i.e. insured depository institutions, bank holding companies, and any affiliate thereof) are eligible to elect the deferral.
— A company would apply the deferral in its first reporting period that includes the date the CARES Act was signed into law (e.g. the first quarter of 2020 for a calendar year-end public company) and reflect the election retrospectively to the beginning of the period.
— Once the deferral has ended, a company will adopt the credit losses standard by applying the effective date and transition provisions in existing US GAAP, which includes an effective date of January 1, 2020 for calendar year-end public business entities that meet the definition of an SEC filer (with the exception of smaller reporting companies, as defined by the SEC).

The CAA extends the date of the deferral to the earlier of:

— the beginning of the company’s fiscal year that begins after the date the COVID-19 national emergency comes to an end; and
— January 1, 2022.

The changes to the end date of the deferral, in particular to the first bullet, remedy some matters that previously necessitated clarification by the SEC staff. The amendments appear to clarify that if the COVID-19 national emergency ends in 2021, a company that has applied the deferral will not have to reflect application of the credit losses standard in its annual or interim financial statements that include the date the national emergency ends. For example, if the COVID-19 national emergency ends on August 31, 2021, a calendar year-end public company can continue to defer applying the credit losses standard until January 1, 2022 (the first day of its next fiscal year); it does not need to reflect application of Topic 326 in its third quarter or annual 2021 financial statements. However, this does not change the fact that when the deferral ends, the effective date of the standard for that company is January 1, 2020 (see third bullet in the preceding paragraph).
Troubled debt restructurings

The CARES Act, as amended by the CAA, permits financial institutions, including insurance companies, to elect not to apply the troubled debt restructuring (TDR) guidance in Topic 310 to modified loans that would have otherwise been categorized as a TDR. The guidance applies only to modifications, including forbearance arrangements, interest rate modifications, repayment plans and any other similar arrangements that defer or delay the payment of principal or interest, that meet the following conditions:

— the loan was not more than 30 days past due as of December 31, 2019;
— the modification is related to the COVID-19 outbreak (i.e. the credit of the borrower was adversely impacted by the coronavirus); and
— the modification was executed between March 1, 2020 and the earlier of (1) 60 days following the date the COVID-19 national emergency comes to an end and (2) December 31, 2020.

In addition, for loans that were issued under the PPP (see background), an insured depository institution or insured credit union that modifies a loan because of COVID-19 on or after March 13, 2020 is not required to apply the TDR guidance in Topic 310.

The CAA modifies the third condition above. The relief from TDR accounting will now apply to modifications executed between March 1, 2020 and the earlier of (1) 60 days following the date the COVID-19 national emergency comes to an end and (2) January 1, 2022.

See KPMG Hot Topic, Lender accounting for COVID-19 loan modifications, for additional information.

Mortgage relief

The CARES Act includes provisions that provide relief to mortgage borrowers with either single or multi-family residential mortgages, respectively, that are backed by the federal government.

Forbearances

The CARES Act’s mortgage payment forbearance (see background) applies if:

— it is requested by the borrower; and
— the borrower affirms that it is experiencing a financial hardship due, directly or indirectly, to the COVID-19 emergency.

The forbearance for a single-family residential mortgage borrower is for a period of up to 180 days, with an option to extend for an additional 180 days, regardless of delinquency status. For a multi-family residential mortgage borrower, the forbearance is for a period of up to 30 days, with an option to extend for two additional 30-day periods, provided the loan was current as of February 1, 2020.

No additional fees, penalties, or interest in excess of those under the original terms of the loans may be accrued and charged by the lender during the period of forbearance.

Lender considerations

Lenders that modify loans in accordance with these sections of the Act will need to adjust the recognition of interest income to reflect the modified terms.

Banking regulators recently issued a joint statement on working with customers affected by COVID-19 (the ‘Interagency Statement’). The Interagency Statement, developed in consultation with the FASB staff, states that modification or deferral programs mandated by the federal or a state government...
related to COVID-19 are not considered to be troubled debt restructurings. See KPMG Hot Topic, Lender accounting for COVID-19 loan modifications.

Borrower considerations

A borrower’s accounting for a debt modification under US GAAP depends on whether it represents a TDR and whether the modified debt has substantially different terms, as summarized in the following decision tree.

- Is the debt modification a TDR?
  - Yes
    - Account for the modified debt as a TDR
  - No
    - Do the old debt and new debt have substantially different terms?
      - Yes
        - Account for the modification as an extinguishment of existing debt and issuance of new debt
      - No
        - Account for the modified debt as a continuation of the existing debt

The accounting guidance that a borrower uses when determining whether a debt modification is a TDR and, if not, the guidance about whether the modification results in recognition of a new debt instrument (with extinguishment of the old instrument) is in Subtopic 470-50 (modifications and extinguishments) and Subtopic 470-60 (troubled debt restructurings by debtors). See KPMG Hot Topic, Potential impacts on the accounting for financial instruments, for further discussion.

Foreclosures

Lenders should consider the timing of foreclosures subject to the CARES Act when estimating the allowance for expected credit losses.

- Lease eviction moratoriums#

The CARES Act’s lease eviction moratorium has expired; however, the CDC residential eviction moratorium is in place. The CDC eviction moratorium places legal requirements on certain lessors but does not change the accounting for leases under Topic 842 or Topic 840.

In general, absent other changes to the terms and conditions of the relevant lease agreement, we do not believe the eviction moratorium modifies any of a lessor’s affected lease agreements. However, if the lessor and the lessee amend other terms and conditions of the lease contract as a result of, or during, the moratorium, a lease modification will generally result. In addition, if the moratorium permits the lessee to stay in the property after the end of the lease term – e.g. the moratorium prevents the lessor from evicting a tenant noncontractually holding over in the property – that would be considered a change to the parties’ enforceable rights and obligations, and the lessor’s accounting may be affected if the lessee is reasonably certain to hold over.

With or without a modification, a lessor may conclude that it is no longer probable it will collect at least substantially all of the lease payments from a tenant protected by the moratorium. In that case, under Topic 842, the lessor should fully reserve for any outstanding receivables from the tenant, and should recognize revenue from the tenant only when/if cash is received. See section 7.5.2 of KPMG Handbook, Leases, for additional information about a lessor’s accounting when this occurs. Lessors still subject to Topic 840 should consider the need to establish or increase their lease receivable reserve. [842-30-25-13]
KPMG Hot Topic, Accounting for rent concessions resulting from the coronavirus outbreak and Hong Kong civil unrest, discusses how Topic 842 applies to rent concessions (e.g. abatements, rent deferrals) arising from temporary property closures and other measures taken in response to COVID-19, while another Hot Topic, FASB staff guidance on accounting for COVID-19 rent concessions, discusses a practical expedient offered by the FASB staff to simplify lessee and lessor accounting for COVID-19 related rent concessions.

The following sections of KPMG Handbook, Leases, provide additional guidance on accounting for lease modifications:

— Section 6.7: Lease modifications – Lessee
— Section 7.6: Lease modifications – Lessor.

### Subsequent events and going concern

#### Subsequent events

The CARES Act and the CAA are current reporting period events for annual and interim reporting periods that include March 27, 2020 (for the CARES Act) and December 27, 2020 (for the CAA). However, the effect of the relief provisions will not necessarily be recognized in the applicable reporting period. Companies should determine the nature of the relief and the applicable guidance, such as income tax, revenue recognition or grant accounting. This will in turn determine on which event recognition is based (e.g. rule enacted, conditions met, claim filed, eligibility confirmed, settlement received).

Additionally, provisions of the CARES Act and/or the CAA may be further developed or clarified in 2021. Companies will also take steps to file for relief and could possibly receive confirmation of their eligibility or settlement of the aid before the financial statements are issued (or available for issuance). Companies should closely monitor those subsequent events to determine which aspects of the Act or the CAA should be recognized at the reporting date – i.e. which ones provide additional evidence about conditions that existed at the reporting date. Understanding the nature of the relief and the applicable guidance is key in this analysis.

#### Examples of subsequent events – reporting date is December 31, 2020; financial statements are issued March 15, 2021

<table>
<thead>
<tr>
<th>Subsequent event</th>
<th>Applicable guidance</th>
<th>Accounting treatment</th>
</tr>
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<tbody>
<tr>
<td>In January 2021, Healthcare Co. obtains clarification about how to calculate the rate adjustments provided under the Act for services it provided to patients in 2020.</td>
<td>The rate adjustment is variable consideration under Topic 606 (revenue).</td>
<td>Recognized subsequent event -- Healthcare Co. takes into account the clarifications for estimating the variable consideration it is entitled to for 2020, before applying the constraint mechanism in Topic 606.</td>
</tr>
<tr>
<td>In January 2021, Company X files for grant assistance under the Act. X had assessed that it met the eligibility criteria on December 31, 2020 (i.e. there were no further conditions to be met past that date and filing</td>
<td>X has elected to account for the grant as a gain contingency under Subtopic 450-30.</td>
<td>Unrecognized subsequent event -- gain contingencies are not recognized until realized or realizable. Settlement is not a recognized subsequent event.</td>
</tr>
</tbody>
</table>
| | X has elected to account for the grant by analogizing to IAS 20. | Possibly a recognized subsequent event -- receipt of
### Subsequent event

<table>
<thead>
<tr>
<th></th>
<th>Applicable guidance</th>
<th>Accounting treatment</th>
</tr>
</thead>
<tbody>
<tr>
<td>is perfunctory). Funds are received on February 1, 2021.</td>
<td>the grant funds by February 1 may confirm that X had reasonable assurance at the reporting date that the grant would be received.</td>
<td></td>
</tr>
</tbody>
</table>

Although Topic 855 generally requires quantitative disclosure of the effect of subsequent events, companies should exercise care when communicating potential contingent gains, to avoid misleading implications about the likelihood of realization. [450-30-50-1, 855-10-50-2]

### Going concern

The relief introduced by the CARES Act and the CAA should also be considered in going concern evaluations. For example, management’s intent and ability to obtain relief under certain provisions thereof, such as government loans or guarantees, could be part of its plans to alleviate substantial doubt about the company’s ability to meet its obligations. [205-40-50-7 – 50-8]

For more detail on reporting subsequent events and going concern evaluations see KPMG Hot Topic, Coronavirus - Subsequent events, going concern, and risks and uncertainties disclosures.

### Evolving information

The potential global and economic impacts of the coronavirus continue to evolve rapidly, and companies should monitor the situation. Companies are encouraged to maintain close communications with their board of directors, external auditors, legal counsel and other service providers as the circumstances progress. Stay informed at read.kpmg.us/coronavirus
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