Accounting and Financial Reporting Challenges in 2020: Adjusting Disclosures During Uncertain Times

White Paper

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Accounting and Financial Reporting Challenges in 2020: Adjusting Disclosures During Uncertain Times

Public companies in the U.S. are grappling with a variety of accounting and financial reporting challenges related to the ongoing COVID-19 pandemic. Many have experienced unforeseen disruptions to their supply chains, work stoppages, abrupt changes in demand for their products and services, and, in some cases, the sudden implosion of their entire business model.

All these events have accounting and financial reporting implications. Consequently, the scourge of uncertainty unleashed by the pandemic has advisors scrambling to comprehend — and responsibly report — how their companies are being affected and how management is responding.

Indeed, one of the most daunting tasks facing accounting professionals right now is the sudden need to provide extensive disclosures detailing the pandemic's impact on the business and how risk in the organization is being managed. In addition to meeting the government's requirements, this information is also necessary to help investors, lenders, and regulators understand the impact the epidemic is having on public companies, which in turn affects valuations. However, the pandemic has generated so much volatility in global markets that determining the virus's impact now and in the future is anyone's guess.

To help accounting professionals understand which accounting and financial procedures are most affected by COVID-19, and what types of guidance the Securities and Exchange Commission (SEC) has provided thus far, Thomson Reuters Checkpoint™ has published a Special Study, *COVID-19 Financial Reporting Considerations (04/2020),* and made further updates to multiple products available on Checkpoint, including *GAAP Reporter, SEC Expert,* and the *Catalyst: U.S. GAAP library.*

Some of the areas accounting professionals should consider are:

Accounting for Debt (Under Topic 470)

- Has there been any virus-related debt restructuring, re-negotiating, or payment deferrals?
- Have any entities received federal loans through the Coronavirus Aid, Relief, and Economic Security (CARES) Act?

If so, be aware that the CARES Act raises a number of accounting questions and includes limitations and restrictions that might impact existing contractual arrangements.

Debt Covenants

- Have any debt covenants been triggered by coronavirus-related activity?

If debt covenants were triggered, companies may want to re-negotiate some of their debt contracts. Otherwise, some or all of the debt may have to be reported as current.

Many lenders are open to restructuring because of COVID-19, but modifications may have to be treated as troubled debt restructurings.

Loan Modifications

- Have you already — or are you currently — renegotiating loans?
- Is any restructuring classified as a troubled debt restructuring (TDR)?
- If a restructuring is not a TDR, is the modification considered an extinguishment of the debt (resulting in a gain or loss)?

Many lenders are open to restructuring because of COVID-19, but modifications may have to be treated as troubled debt restructurings (although this concern has recently been alleviated by the FASB and the CARES Act, which allow some modifications due to COVID-19 not to be treated as TDRs).

Collateralized Debt

- Has market volatility affected the fair value of collateral securing your business's debts?

If so, the value of the collateral may no longer be sufficient to secure the debt.

In its Form 10-Q for Q2 2020, Digimarc Corporation disclosed the following regarding the terms and conditions of its PPP loan:

Loan Under the Paycheck Protection Program

On April 16, 2020, the Company entered into a loan with Stearns Bank, N.A. in an aggregate principal amount of $5,032 (the "Loan"), pursuant to the Paycheck Protection Program (the "PPP") under the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act").

The Loan is evidenced by a promissory note (the "Note") dated April 16, 2020, which is attached as Exhibit 10.1 to this Form 10-Q. The Loan matures two years from the disbursement date and bears interest at a rate of 1.000% per annum, with the first six months of interest deferred. Principal and interest are payable monthly commencing six months after the disbursement date and may be prepaid by the Company at any time prior to maturity with no prepayment penalties.

Under the terms of the CARES Act, PPP loan recipients can apply for and be granted forgiveness for all or a portion of loans granted under the PPP. The Loan is subject to forgiveness to the extent proceeds are used for payroll costs, including payments required to continue group health care benefits, and certain rent, utility, and mortgage interest expenses (collectively, "Qualifying Expenses"), pursuant to the terms and limitations of the PPP. The Company intends to use a significant majority of the Loan amount for Qualifying Expenses. However, no assurance is provided that the Company will obtain forgiveness of the Loan in whole or in part.

Derivatives and Hedging (Under Topic 815)

- Are hedging strategies and derivatives being used to manage risk?
- Are hedges still effective and do they still qualify for hedge accounting?
- Are forecasted transactions in hedges of forecasted transactions still expected to occur?

In the era of COVID-19, be aware that many factors affecting the value of derivatives and hedges — interest rates, security prices, commodity prices, exchange rates — are all moving in unpredictable directions and hedge accounting may have to be discontinued. Also, forecasted transactions may be delayed or may no longer be expected to occur, which may impact the accounting.

In its Form 10-Q for the period ended February 29, 2020, Carnival Corporation disclosed the following:

The spread of COVID-19 and the recent developments surrounding the global pandemic are having material negative impacts on all aspects of our business. On March 13, 2020, we announced voluntary pauses of our global fleet cruise operations across all brands. The duration of the pauses will be dependent in part on various travel restrictions and travel bans issued by countries around the world.

(...)

In March 2020, we early settled all outstanding cross currency swaps designated as net investment hedges and received proceeds of $180 million, of which $167 million will remain in AOCI until either the sale or substantially complete liquidation of the related subsidiary. We also early settled our foreign currency forwards that were designated as cash flow hedges and received proceeds of $53 million which will remain in AOCI until recognized in earnings proportionately to the related depreciation expense of the underlying vessel that was hedged.

Fair Value Measurements (Under Topic 820)

- Has the coronavirus changed how the fair value of assets is being measured?

Volatile market conditions may warrant a change in valuation techniques and inputs, but the rationale behind the change must be explained and disclosed.

Fair Value Hierarchy and Disclosure

- Have fair value measurements under COVID-19 affected the entity's fair value hierarchy?

If so, changes may need to be highlighted and explained in disclosures, because stakeholders will want to understand the rationale behind the changes.

In its Form 10-Q for period ended March 31, 2020, HSBC USA Inc. disclosed how it changed its economic scenarios underlying its fair value measurement:

Updates to Economic Scenarios and Other Changes During the Three Months Ended March 31, 2020 As a result of the deterioration in economic conditions caused by the spread of the COVID-19 pandemic during the first quarter of 2020 and the related increase in economic uncertainty given the rapidly changing economic impact, we determined that the Consensus Economic Scenarios described above were no longer representative of management's current view of forecasted economic conditions and, as a result, three new COVID-19 forward-looking economic scenarios were developed and utilized for estimating lifetime ECL at March 31, 2020. The three new COVID-19 scenarios, referred to as mild, moderate and severe, were assigned weightings with the majority of the weighting placed on the mild scenario and progressively lower weights placed on the moderate and severe scenarios. This weighting was deemed appropriate for the estimation of lifetime ECL under current conditions. The following discussion summarizes the COVID-19 macroeconomic variable forecasts in the mild, moderate and severe scenarios at March 31, 2020.

In the mild scenario, widespread and large-scale movement restrictions and social distancing measures are lifted by the end of 2020. In this scenario, GDP growth contracts for one quarter, before rebounding towards its historical average, while unemployment and housing prices both worsen modestly for a period of one to two years. In the financial markets, equity prices experience a correction, reflecting the COVID-19 impact on corporate earnings, and the 10-year U.S. Treasury yield falls into negative territory due to supportive monetary policy.

In the moderate scenario, widespread and large-scale movement restrictions and social distancing measures are sustained, lifting by the second quarter of 2021. In this scenario, the economic downturn lasts longer than in the mild scenario. As a result, the unemployment rate increases significantly in 2020 and the first half of 2021, before gradually returning to its historical average in 2022. Weakness in the housing market lingers, with the price level not returning to the pre-pandemic level until 2027, while equity prices decline by over 20 percent by the end of 2020.

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In the severe scenario, widespread and large-scale movement restrictions and social distancing measures are sustained further, lifting at different paces over the course of 2021. In this scenario, GDP growth contracts substantially in 2020 and stays flat in 2021. The housing downturn lasts longer than in the moderate and mild scenarios, with the decline in housing prices exceeding 20 percent. The unemployment rate spikes to the peak level from the 2007-2009 recession, and remains elevated above the long-term average in 2022 and 2023. The decline in equity prices exceeds 40 percent by the end of 2020, while the 10-year U.S. Treasury yield falls below (1) percent beginning in the second quarter of 2020.

In addition to the updates to the economic scenarios, we recorded a management judgment allowance which increased our consumer allowance for credit losses by $41 million to consider the extent of recent economic events and deteriorating conditions that were not fully captured in the economic scenarios applied at March 31, 2020. The circumstances around this pandemic are evolving rapidly and will continue to impact our business and our allowance for credit losses in future periods. The details of how various U.S. Government actions will impact our customers and therefore the impact on our allowance for credit losses remains highly uncertain. We will continue to monitor the COVID-19 situation closely and anticipate returning to utilizing our Consensus Economic Scenarios approach as described above if and when the economic environment in the United States improves and returns to more normal conditions.

We also increased our management judgment allowance for risk factors associated with large loan exposure in our commercial loan portfolio by $95 million to $220 million at March 31, 2020, reflecting an increase in projected large loan defaults given the deterioration in economic conditions during the quarter.

Going Concern (Under Subtopic 205-40)

- Can the company continue to meet its financial obligations?
- Do the company's financial challenges represent an existential threat?
- Has the entity initiated measures to mitigate losses and risk?

If an assessment of a company's financials reveals substantial doubt about its ability to continue as a going concern, the reasons why must be reported, as well as any actions the company plans to take in order to address the adverse circumstances or events that have affected it.

If an assessment of a company's financials reveals substantial doubt about its ability to continue as a going concern, the reasons why must be reported, as well as any actions the company plans to take in order to address the adverse circumstances or events that have affected it.

In its Form 10-Q for the period ended May 2, 2020, J C Penny CO INC disclosed the following about its ability to continue as a going concern:

The unaudited Interim Consolidated Financial Statements included in this Quarterly Report on Form 10-Q have been prepared on a going concern basis of accounting, which contemplates continuity of operations, realization of assets, and satisfaction of liabilities and commitments in the normal course of business. As a result of the Chapter 11 Cases, the realization of assets and the satisfaction of liabilities are subject to significant uncertainty. While operating as a debtor-in-possession pursuant to the Bankruptcy Code, we may sell, or otherwise dispose of or liquidate, assets or settle liabilities, subject to the approval of the Bankruptcy Court or as otherwise permitted in the ordinary course of business, for amounts other than those reflected in the accompanying unaudited Interim Consolidated Financial Statements. Further, a Chapter 11 plan of reorganization is likely to materially change the amounts and classifications of assets and liabilities reported in our unaudited Interim Consolidated Balance Sheet as of May 2, 2020. In addition, the COVID-19 pandemic has, and continues to have, a material impact on the Company's business operations, financial position, liquidity, capital resources and results of operations (see Note 2). The risks and uncertainties surrounding the Chapter 11 Cases, the defaults under our debt agreements (see Note 8), and our financial condition, raise substantial doubt as to the Company's ability to continue as a going concern. Our future plans, including those in connection with the Chapter 11 Cases, are not yet finalized, fully executed or approved by the Bankruptcy Court, and therefore cannot be deemed probable of mitigating this substantial doubt within 12 months of the date of issuance of these financial statements. Our consolidated financial statements do not include any adjustments related to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should we be unable to continue as a going concern.

Impairment — Financial Instruments

Accounting for Credit Losses Under Topic 326

- When reporting credit losses, which accounting method is being used — e.g., discounted cash flows, loss rate, roll rate, probability of default?
- Does any pool of assets need to be readjusted to reflect changes in the risk characteristics of the assets?
- Are there any Purchased Financial Assets with Credit Deterioration (PCD assets) on the books?

The pandemic has clouded many factors involved in measuring credit losses, creating a great deal of uncertainty about the estimates accountants may use.

In its Form 10-Q for the period ended June 30, 2020, SLM Corp disclosed the following regarding how COVID-19 is affecting the way it assesses the probability of default on its loans owned for investment:

The COVID-19 pandemic is having far reaching, negative impacts on individuals, businesses, and, consequently, the overall economy. Specifically, COVID-19 has materially disrupted business operations throughout the country, resulting in significantly higher levels of unemployment or underemployment. As a result, we expect many of our individual customers will experience financial hardship, making it difficult, if not impossible, to meet their payment obligations to us without temporary assistance. We are monitoring key metrics as early warning indicators of financial hardship, including changes in weekly unemployment claims, enrollment in auto-debit payments, requests for new forbearances, enrollment in hardship payment plans, and early delinquency metrics.

As a result of the negative impact on employment from COVID-19, our customers are experiencing higher levels of financial hardship, which we expect will lead to higher levels of forbearance, delinquency, and defaults. We expect that, left unabated, this deterioration in forbearance, delinquency, and default rates will persist until such time as the economy and employment return to relatively normal levels.

We assist customers with an array of payment programs during periods of financial hardship as standard operating convention, including: forbearance, which defers payments during a short-term hardship; our Graduated Repayment Plan (“GRP”), which is an interest-only payment for 12 months; or a loan modification that, in the event of long-term hardship, reduces the interest rate on a loan to 4 percent for 24 months and/or permanently extends the maturity date of the loan. Historically, we have utilized disaster forbearance for material events, including hurricanes, wildfires, and floods. Disaster forbearance defers payments for as much as 90 days upon enrollment. We have invoked this same disaster forbearance program to assist our customers through COVID-19 and offer this program across our operations, including through mobile app and self-service channels such as chat and interactive voice response (“IVR”). Customers who receive a disaster forbearance will not progress in delinquency and will not be assessed late fees or other fees. During a disaster forbearance, a customer’s credit file will continue to reflect the status of the loan as it was immediately prior to granting the disaster forbearance. During the period of the disaster forbearance, interest will continue to accrue, but is not capitalized to the loan balance after the loan returns to repayment status. The first wave of disaster forbearance was granted primarily in 90-day increments. As these forbearances end, we will reduce the disaster forbearance to one-month increments and implement additional discussions between our servicing agents and borrowers to encourage borrowers/cosigners to enter repayment. In addition, for borrowers exiting disaster forbearance and not eligible for GRP, we may allow them to make interest only payments for 12 months before reverting to full principal and interest payments. If the financial hardship extends beyond 90 days, additional assistance will be available for eligible customers. These programs are applied across our Private Education Loan and Personal Loan portfolios.

Management continually monitors our credit administration practices and may periodically modify these practices based upon performance, industry conventions, and/or regulatory feedback. In light of these considerations, we previously announced that we plan to implement certain changes to our credit administration practices in the future. As discussed below, however, we have postponed until the fourth quarter of 2020 the implementation of the announced credit administration practices changes due to the COVID-19 pandemic.

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Specifically, we previously announced that we plan to revise our credit administration practices limiting the number of forbearance months granted consecutively and the number of times certain extended or reduced repayment alternatives may be granted. For example, we currently grant forbearance to borrowers without requiring any period of prior principal and interest payments, meaning that, if a borrower satisfies all eligibility requirements, forbearance increments may be granted consecutively. We previously announced that, beginning in the second quarter of 2020, we would phase in a required six-month period between successive grants of forbearance and between forbearance grants and certain other repayment alternatives. We announced this required period will not apply, however, to forbearances granted during the first six months following a borrower's grace period and will not be required for a borrower to receive a contractual interest rate reduction. In addition, we announced we would limit the participation of delinquent borrowers in certain short-term extended or interest-only repayment alternatives to once in 12 months and twice in five years.

As previously announced, prior to full implementation of the credit administration practices changes described above, management will conduct a controlled testing program on randomly selected borrowers to measure the impact of the changes on our customers, our credit operations, and key credit metrics. The testing commenced in October 2019 for some of the planned changes on a very small percentage of our total portfolio and we originally expected to expand the number of borrowers in repayment who would be subject to the new credit administration practices. However, due to the COVID-19 pandemic, we have postponed our efforts to roll out in a methodical approach the implementation of the credit administration practices changes and related testing until the fourth quarter of 2020 so that we can be more flexible in dealing with our customers' financial hardship. Management now expects to have completed implementation of the planned credit administration practices changes by year-end 2022. However, we may modify or delay the contemplated practice changes, the proposed timeline, or the method of implementation as we learn more about the impacts of the program on our customers.

We also offer rate and term modifications to customers experiencing more severe hardship. Currently, we temporarily reduce the contractual interest rate on a loan to 4.0 percent (previously, to 2.0 percent) for a two-year period and, in the vast majority of cases, permanently extend the final maturity date of the loan. As part of demonstrating the ability and willingness to pay, the customer must make three consecutive monthly payments at the reduced payment to qualify for the program. The combination of the rate reduction and maturity extension helps reduce the monthly payment due from the borrower and increases the likelihood the borrower will remain current during the interest rate modification period as well as when the loan returns to its original contractual interest rate. At June 30, 2020 and December 31, 2019, 8.9 percent and 7.2 percent, respectively, of our loans then currently in full principal and interest repayment status were subject to interest rate reductions made under our rate modification program. We currently have no plans to change the basic elements of the rate and term modifications we offer to our customers experiencing more severe hardship.

While there are limitations to our estimate of the future impact of the credit administration practices changes described above, absent the effect of any mitigating measures, and based on an analysis of borrower behavior under our current credit administration practices, which may not be indicative of how borrowers will behave under revised credit administration practices, we expect that the credit administration practices changes described above will accelerate defaults and could increase life of loan defaults in our Private Education Loan portfolio by approximately 4 percent to 14 percent. Among the measures that we are planning to implement and expect may partly offset or moderate any acceleration of or increase in defaults will be greater focus on the risk assessment process to ensure borrowers are mapped to the appropriate program, better utilization of existing programs (e.g., GRP and rate modifications), and the introduction of a new program offering short-term payment reductions (permitting interest-only payments for up to six months) for certain early stage delinquencies.

The full impact of these changes to our collections practices described above may only be realized over the longer term, however. In particular, when we calculate the allowance for loan losses under CECL, which became effective on January 1, 2020, our loan loss reserves increased materially because we expect the life of loan defaults on our overall Private Education Loan portfolio to increase, in part as a result of the planned changes to our credit administration practices. As we progress with the controlled testing program of the planned changes to our credit administration practices, we expect to learn more about how our borrowers are reacting to these changes and, as we analyze such reactions, we will continue to refine our estimates of the impact of those changes on our allowance for loan losses.

Impairment: Goodwill and Other Intangible Assets (Under Topic 350)

- Has COVID-19 triggered an interim goodwill impairment test?
- Does the test indicate an impairment?

For many companies, COVID-19 may be a triggering event, requiring companies to test their goodwill for impairment. With many inputs being highly volatile and difficult to predict, determining whether goodwill is impaired is no small task.

For many companies, COVID-19 may be a triggering event, requiring companies to test their goodwill for impairment.

In its Form 10-Q for Q2 2020, Whirlpool Corp. disclosed the following regarding its goodwill and other intangible assets:

Goodwill and indefinite-lived intangible assets

Our Critical Accounting Policies and Estimates for goodwill and other indefinite-life intangibles are disclosed in Note 1 to the Consolidated Financial Statements and in Management's Discussion and Analysis of our annual report on Form 10-K for the fiscal year ended December 31, 2019.

We continue to monitor the significant global economic uncertainty as a result of COVID-19 to assess the outlook for demand for our products and the impact on our business and our overall financial performance. The goodwill in our EMEA reporting unit and our *Indesit, Hotpoint** and *Maytag* trademarks continue to be at risk at June 30, 2020. The goodwill in our other reporting units or indefinite-lived intangible assets are not presently at risk for future impairment.

The potential impact of COVID-19 related demand disruptions, production impacts and supply constraint impacts on our operating results for the EMEA reporting unit in the short-term is uncertain, but we remain committed to the strategic actions necessary to realize the long-term forecasted EBIT margins and expect that the macroeconomic environment will recover in the medium to long-term. The potential negative demand effect on revenues for the *Indesit* and *Hotpoint** trademarks and the *Maytag* trademark is also uncertain given the volatile environment, but we expect that demand and production levels will also recover.

As a result of our analysis, and in consideration of the totality of events and circumstances, there were no triggering events of impairment identified during the second quarter of 2020.

A lack of recovery or further deterioration in market conditions, a sustained trend of weaker than expected financial performance in EMEA or for our *Indesit, Hotpoint** and *Maytag* trademarks or a lack of recovery or further decline in the Company's market capitalization, among other factors, as a result of the COVID-19 pandemic or other unforeseen events could result in an impairment charge in future periods which could have a material adverse effect on our financial statements.

* Whirlpool ownership of the Hotpoint brand in EMEA and Asia Pacific regions is not affiliated with the Hotpoint brand sold in the Americas.

Income Taxes (under Topic 740)

Realizability of Deferred Tax Assets and Valuation Allowances

- Does the company have to record valuation allowances on deferred tax assets?

COVID-19 has caused severe operational disruptions that could endanger a company's future taxable income and therefore bring into question the realizability of its deferred tax assets.

Undistributed Earnings and the Indefinite Reinvestment Assertion

- Are profits from a foreign subsidiary being permanently reinvested or do they have to be repatriated to the U.S.?
- Do liquidity needs born from the pandemic raise questions about a company's "permanent reinvestment" strategy?

Be aware that assertions of permanent reinvestment and other tax strategies relating to foreign income may be complicated by COVID-19 concerns.

Interim Reporting Requirements

Estimating the Annual Effective Tax Rate:

- Are there any difficulties in estimating an overall annual effective tax rate?

The effective tax rate on individual transactions may be difficult to estimate because of the coronavirus's uneven impact on different states and jurisdictions.

Accounting for Discrete Tax Effects

- Have COVID-19 complications resulted in impairment losses, debt restructurings, re-negotiated contracts and leases, or other disruptions to the normal flow of business?

For tax purposes, such events are generally considered unusual or infrequent, and their tax effects are accounted for as discrete items under Topic 740.

The CARES Act and subsequent relief bills passed by the federal government are intended to inject liquidity into the market and provide economic relief in the form of federal tax cuts, credits, and grants to businesses large and small.

Enactment of the CARES Act

The CARES Act and subsequent relief bills passed by the federal government are intended to inject liquidity into the market and provide economic relief in the form of federal tax cuts, credits, and grants to businesses large and small.

A few sections of the CARES Act that may affect a U.S. corporation's accounting for income taxes involve:

- Act Section 2303 – Allows a reporting entity to fully utilize net-operating-loss (NOL) carry forwards to offset taxable income in 2018, 2019, and 2020.
- Act Section 2303 – Allows a reporting entity to carryback NOLs generated in 2018, 2019, and 2020. The NOLs can be carried back five years.
- Act Section 2306 – Raises the limitation on the net interest expense deduction to 50% for the 2019 and 2020 tax years.
- Act Section 2305 – Allows a reporting entity to claim a refund for the full amount of an alternative minimum tax credit.
- Act Section 2205 – Raises the limitation on deductible charitable cash contributions.

In its Form 10-Q for the period ended June 13, 2020, Pepsico Inc disclosed the effect of the CARES act on its annual estimated effective tax rate:

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was enacted on March 27, 2020 in the United States. The CARES Act and related notices include several significant provisions, including delaying certain payroll tax payments, mandatory transition tax payments under the TCJ Act, and estimated income tax payments that we are deferring to future periods. We do not currently expect the CARES Act to have a material impact on our financial results, including on our annual estimated effective tax rate or on our liquidity. We will continue to monitor and assess the impact the CARES Act and similar legislation in other countries may have on our business and financial results.

Inventory (Under Topic 330)

- Does the company have problems moving — or maintaining — inventory?
- Does the cost of the inventory exceed its market value, which may result in a loss
- Are you operating at normal capacity? Should overhead allocations be changed?

Measurement of inventory during COVID-19 can be difficult, especially if sales and production have stalled or normal record-keeping and on-site audits are disrupted.

In its Form 10-Q for the period ended May 31, 2020, CHS Inc. disclosed the following about the measurement of its inventory:

During the third quarter of fiscal 2020, we experienced price declines in our energy inventories associated with the novel corona virus COVID-19 pandemic. As a result, we recorded a noncash, lower of cost or market charge of $42.0 million in cost of goods sold to reduce the carrying value of our energy inventories to their market value at the end of the period. This charge may increase or decrease in the fourth quarter of fiscal 2020, based upon market prices observed at our fiscal year-end. Any adjustments that exist as of our fiscal year-end would be incorporated into the LIFO carrying value of the inventories.

Leases (Under Topic 842)

- Have any rent concessions or renegotiated lease terms already been granted temporarily or permanently?
- Is the business renegotiating additional changes to its lease agreements?
- Are any right-of-use (ROU) assets now considered impaired?

COVID-19 has upended the market for commercial properties, making it necessary for many companies to re-evaluate — or re-negotiate — terms and conditions agreed to prior to the pandemic.

In its Form 10-Q for the period ended June 30, 2020, HERC Holdings, Inc. disclosed how it accounted for rent concessions:

In response to the impact of COVID-19 on the Company's operations, the Company engaged in negotiations with its landlords regarding rent concessions. The Company has received a rent abatement on certain properties ranging from one to three months and has elected to recognize these concessions as a variable credit to rent expense in accordance with the relief issued by the FASB titled ASC Topic 842 and ASC Topic 840: Accounting for Lease Concessions Related to the Effects of the COVID-19 Pandemic. The Company has also received a rent abatement in exchange for an extension of the term of the lease on other properties and the Company has accounted for these arrangements as lease modifications.

Revenue Recognition (Under Topic 606)

- Is collectability of revenue an issue?
- Have refund or return policies changed?
- Are contracts still expected to be completed on time?
- Are there any new goods or services offered to customers in light of the pandemic?
- Have the terms of customer contracts been otherwise modified?

The new revenue recognition standard has conditions that may prevent companies from recognizing revenues or parts thereof during the coronavirus pandemic. Also, many companies have modified contracts with customers due to COVID-19 and must consider the accounting implications.

In its Form 10-Q for the period ended May 31, 2020, Carnival Corporation disclosed changes to the terms of its customer contracts due to the pandemic:

Our payment terms generally require an initial deposit to confirm a reservation, with the balance due prior to the voyage. Cash received from guests in advance of the cruise is recorded in customer deposits and in other long-term liabilities on our Consolidated Balance Sheets. These amounts include refundable deposits. We are providing flexibility to guests with bookings on sailings cancelled due to the pause in cruise operations by allowing guests to receive enhanced future cruise credits ("FCC") or elect to receive refunds in cash. We expect to be required to pay cash refunds of customer deposits with respect to a portion of these cancelled cruises. The amount of cash refunds to be paid may depend on the length of the pause and level of guest acceptance of FCCs. We record a liability for FCCs to the extent we have received cash from guests with bookings on cancelled sailings. We had customer deposits of $2.9 billion as of May 31, 2020 and $4.9 billion as of November 30, 2019. The current portion of our customer deposits was $2.6 billion as of May 31, 2020. These amounts include deposits related to cancelled cruises prior to the election of a cash refund by guests. Refunds payable to guests who have elected cash refunds are recorded in accounts payable. Due to the uncertainty associated with the duration and extent of COVID-19, we are unable to estimate the amount of the May 31, 2020 customer deposits that will be recognized in earnings compared to amounts that will be refunded to customers or issued as a credit for future travel. During the six months ended May 31, 2020 and 2019, we recognized revenues of $3.5 billion and $3.7 billion related to our customer deposits as of November 30, 2019 and December 1, 2018. Historically, our customer deposits balance changes due to the seasonal nature of cash collections, the recognition of revenue, refund of customer deposits and foreign currency translation.

Liquidity

- Has the pandemic created liquidity risks for the Company?
- How is the Company managing its liquidity risk during this crisis?

Reporting entities may have to revise their disclosures about liquidity risks to let investors know how they are managing their liquidity while dealing with the COVID-19 crisis.

In its Form 10-Q for Q2 2020, Spirit Airlines, Inc disclosed the following regarding its liquidity:

Since the onset of the spread of COVID-19 in the U.S. in the first quarter of 2020, the Company has taken several actions to increase liquidity and strengthen its financial position. As a result of these actions, as of June 30, 2020, the Company had unrestricted cash and cash equivalents and short-term investment securities of $1,233.8 million.

In March 2020, the Company entered into a senior secured revolving credit facility (the "2022 revolving credit facility") for an initial commitment amount of $110.0 million, and subsequently, in the second quarter of 2020, increased its commitment amount to $180.0 million. As of June 30, 2020, the Company had fully drawn the available amount of $180.0 million under the 2022 revolving credit facility. The 2022 revolving credit facility matures on March 30, 2022. The Company continues to pursue additional financing secured by its unencumbered assets. Refer to Note 13, Debt and Other Obligations, for additional information about the 2022 revolving credit facility.

On May 12, 2020, the Company completed the public offering of $175.0 million aggregate principal amount of 4.75% convertible senior notes due 2025 (the "convertible notes"). The convertible notes will bear interest at the rate of 4.75% per year and will mature on May 15, 2025. Interest on the convertible notes is payable semi-annually in arrears on May 15 and November 15 of each year, beginning on November 15, 2020. The Company received proceeds of $168.3 million, net of total issuance costs of $6.7 million and recorded $95.6 million in long-term debt, net of debt issuance costs of $3.8 million on its condensed balance sheets, related to the debt component of the convertible notes, and $72.7 million in APIC, net of issuance costs of $2.9 million on its condensed balance sheets, related to the equity component of the convertible notes. Refer to Note 13, Debt and Other Obligations for additional information about the Company's convertible debt.

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Also on May 12, 2020, the Company completed the public offering of 20,125,000 shares of its voting common stock, which includes full exercise of the underwriters' option to purchase an additional 2,625,000 shares of common stock, at a public offering price of $10.00 per share (the "common stock offering"). The Company received proceeds of $192.4 million, net of issuance costs of $8.9 million. Refer to Note 14, Equity, for further information about the Company's common stock offering.

In June 2020, the Company entered into an agreement to amend its revolving credit facility entered into in 2018 to finance aircraft pre-delivery payments. The agreement amends the revolving credit facility to extend the final maturity date from December 30, 2020 to March 31, 2021. Upon execution of the amended agreement, the maximum borrowing capacity decreased from $160.0 million to $111.2 million and during the six months ended June 30, 2020 we made net principal payments of $48.8 million. This facility is secured by the collateral assignment of certain of the Company's rights under the purchase agreement with Airbus, related to 20 Airbus A320neo aircraft scheduled to be delivered between August 2020 and October 2022. The initial maximum borrowing capacity of $111.2 million will continue to decrease as the Company takes delivery of the related aircraft. The amendment will provide an additional approximately $54 million in liquidity through March 2021. Refer to Note 13, Debt and Other Obligations, for further information.

Also, in June 2020, the Company entered into an agreement to defer certain aircraft deliveries originally scheduled in 2020 and 2021, as well as the related pre-delivery deposit payments. During the six months ended June 30, 2020, the Company took delivery of 9 aircraft and with this agreement, the Company has 3 remaining aircraft scheduled for delivery during the remainder of 2020 and 16 aircraft scheduled for delivery in 2021. Refer to Note 11, Commitments and Contingencies, for further information about the Company's future aircraft deliveries.

In addition, since the onset of the COVID-19 pandemic, the Company has taken additional action, including:

- Reduced planned discretionary non-aircraft capital spend in 2020 by approximately $50 million;
- Deferred $20 million in heavy maintenance events from 2020 to 2021;
- Reduced planned non-fuel operating costs for 2020 by $20 million to $30 million, excluding savings related to reduced capacity;
- Suspended hiring across the Company except to fill essential roles;
- Entered into agreements to defer payments in 2020 related to facility rents and other airport services contracts at certain locations;
- Continued to work with lessors and service providers to temporarily defer aircraft rent and other maintenance and service contract payments;
- Continued to work with unionized and non-unionized employees to create voluntary leave programs;
- Continued to pursue additional financing secured by its unencumbered assets.

The Company continues to engage in discussions with the Company's significant stakeholders and vendors regarding financial support or contract adjustments, including extensions of payment terms, during this transition period.

For purposes of assessing its liquidity needs, the Company estimates that demand will continue to improve slightly in the second half of 2020, but remain well below 2019 levels, and continue to recover into 2021. The Company believes the actions described above address its future liquidity needs, yet anticipates it may implement further discretionary changes and other cost reduction and liquidity preservation measures, as needed, to address the volatility and quickly changing dynamics of passenger demand and the impact of revenue changes, regulatory and public health directives and prevailing government policy and financial market conditions.

Summary

For corporate entities around the world, a tsunami of uncertainty has accompanied the global coronavirus pandemic as the outbreak continues to disrupt supply chains, displace workers, alter consumer behavior, and stall significant portions of the economy.

Accounting professionals are facing a number of accounting and financial reporting challenges during this unique moment in history. The ripple effects of COVID-19 are so vast and insidious that few aspects of financial reporting have been left untouched, and persistent uncertainty over the duration of the pandemic has companies scrambling to adapt.

The SEC has been issuing regular guidance updates for companies on how to factor coronavirus risks into their reporting and disclosure practices. However, the fluidity of the situation has made it difficult (and sometimes impossible) for many businesses to predict what the ultimate impact of the pandemic on their business will be.

Thomson Reuters has added regular COVID-19 updates to a number of products in its Checkpoint suite, and continues to develop its COVID-19 Resource Center as a vital news portal. Accounting professionals who want fast answers to their questions and up-to-date information on the latest COVID-19 developments need look no further than their nearest Thomson Reuters representative.

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