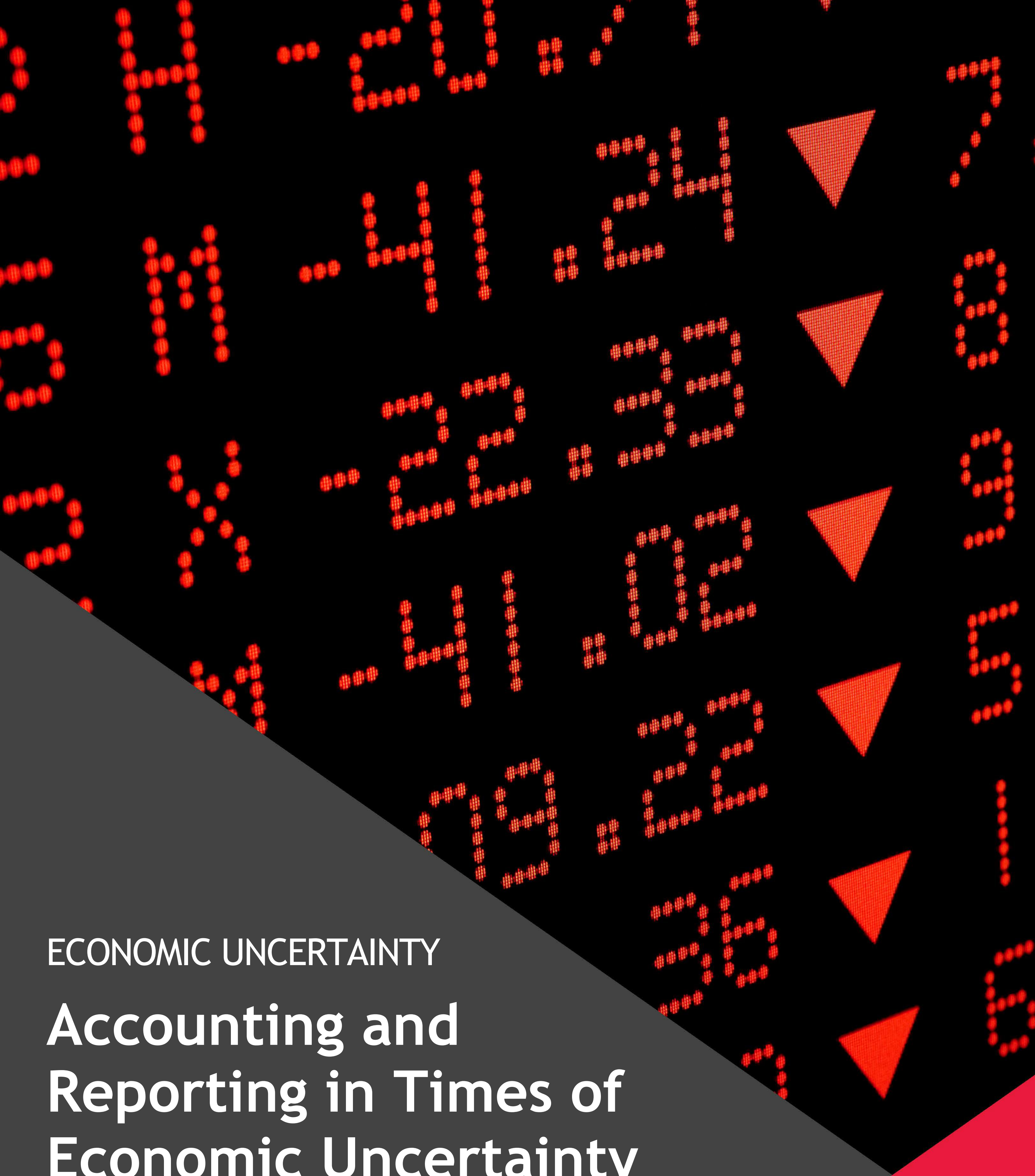


ECONOMIC UNCERTAINTY

Accounting and Reporting in Times of Economic Uncertainty

June 2025

TABLE OF CONTENTS

INTRODUCTION

Economic uncertainty can arise whenever unexpected events disrupt the status quo. For example, it can arise when valuations of specific asset classes become over-inflated or when natural disasters (such as hurricanes, floods, earthquakes, and forest fires) cause widespread damage, particularly to economically important regions or industries. It can arise from geopolitical tensions, wars, terrorism, international sanctions, and changes in trade policy, tariffs, and regulatory agendas. Economic uncertainty can also arise when costs rise more quickly than expected (for example, due to labor shortages during the COVID-19 pandemic or whenever there is a sudden change in oil and gas prices). These events and others can trigger stock market volatility, which can cause changes in consumer behavior, triggering even more volatility. Often, such events tend to compound, as businesses not directly affected by an event are affected by secondary and tertiary effects.

Because these events are usually unexpected, businesses often react quickly in ways they might not otherwise consider (for example, selling assets, terminating employees, finding alternative financing), and such actions have accounting and reporting consequences. Management may also change a business strategy, or how the entity transacts with customers or vendors in times of economic uncertainty, which can also affect financial reporting. But even when a business tries to keep the status quo and wait out the cycle of economic disruption, it still must consider the financial reporting effects of changes in the macroeconomic environment, and how those changes affect the measurement of its assets and liabilities, as well as the transparency of its disclosures.

Having a robust system of internal controls over financial reporting (ICFR) is imperative to identifying the financial reporting consequences in times of economic uncertainty. While management must lead the charge, the audit committee and the auditors also have a vital role in verifying that these controls are operating effectively. The SEC and other regulators focus on the transparency and quality of financial reporting in times of economic uncertainty, particularly in estimating the value of assets in accordance with U.S. generally accepted accounting principles (GAAP), and in describing the inputs and judgments in critical areas, including forward-looking information.

Accordingly, in times of economic uncertainty, those responsible for preparing the financial statements and other reports should communicate frequently with management to fully understand how current events (and reasonably foreseeable potential future events) are affecting the business and to understand management’s current and long-term plans to address changing circumstances. Armed with this information, management should review each financial statement account and considering what new risks have evolved, which estimates are affected, what accounting issues might arise, and what new disclosures are necessary (or need significant revision).

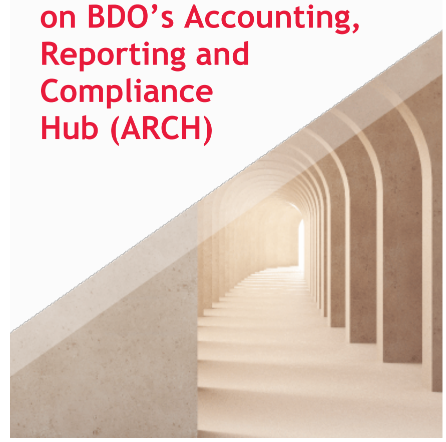
About This Publication

This publication can be a useful tool to help management analyze financial reporting issues in times of economic uncertainty, but to perform a comprehensive analysis, management must consider the specific facts and circumstances the business is facing, as well as the specific events causing economic disruption in the macroeconomic environment. This analysis must consider changes in the facts and circumstances and the macroeconomic environment at each balance sheet date. Staying up to date on changes in U.S. GAAP, interpretive guidance, and relief granted by the SEC and others in times of economic uncertainty is also important, as such events often set off changes in accounting and reporting requirements. Find the latest publications from BDO’s Professional Practice Group **on** [BDO’s ARCH].

This publication is designed to raise issues for awareness and to provide resources for more detailed analysis. An entity’s facts and circumstances may vary from those described in this publication; therefore, an entity’s conclusions may vary.

This publication focuses on U.S. GAAP. More information on accounting and reporting in times of economic uncertainty under International Financial Reporting Standards (IFRS) is available here.

Find our latest accounting and reporting publications on BDO’s Accounting, Reporting and Compliance Hub (ARCH)



1. ACCOUNTING: CONSIDERATIONS IN TIMES OF ECONOMIC UNCERTAINTY

Economic uncertainty can significantly affect business activities and cause severe market disruptions. Typically, an event that leads to economic uncertainty creates an evolving situation that management needs to continually assess and analyze, particularly when determining whether a downward measurement adjustment is required for assets or whether the entity needs to recognize new liabilities. The following discussion highlights key financial statement areas that may be affected in times of economic uncertainty.

1.1 Receivables and Loans

FASB REFERENCES

ASC 310-20, *Receivables — Nonrefundable Fees and Other Costs*, and ASC 326, *Financial Instruments — Credit Losses*

During times of economic uncertainty, a customer or borrower may find it difficult to repay amounts due. An entity may try to collect those amounts by restructuring the arrangement or offering concessions to mitigate further losses.

Under current U.S. GAAP, all entities are required to consider collectibility for receivables and loans measured at amortized cost and recognize an allowance for credit losses (which may be referred to in practice as an allowance for doubtful accounts or a bad debt reserve). Such requirements apply to all entities, in all industries; the scope of ASC 326 is not limited to banks or other financial institutions.

ASC 326 requires an entity to recognize an allowance using the current expected credit losses (CECL) model, which considers historical experience, current conditions, and reasonable and supportable forecasts. For example, if relevant to estimating an entity's credit losses, an entity would consider projected changes during the forecast period in unemployment rates, property values, commodity values, delinquency, or other factors that affect its credit losses.

In times of economic uncertainty, changes in facts and circumstances and the macroeconomic environment may affect an entity's allowance for credit losses. For example:

- Historical experience may be less relevant or informative if such experience does not include similar periods of economic uncertainty.
- Forecasts of future economic conditions may be harder to project, and less reliable.
  - In times of economic uncertainty, credit losses may occur at a higher rate and the entity may need to update the assumptions used in estimating expected credit losses to reflect current and forecasted conditions. However, an entity cannot include the expected effect of loan modifications in its estimate unless an extension or renewal option exists in the contract at the reporting date that is noncancellable by the lender.
- Pools of loans and receivables that previously had similar risk characteristics may no longer be similar.
- Quantitative and qualitative disclosures may need significant revisions or disaggregation, and more detailed disclosures about inputs, assumptions, and estimates may be required.

FASB PROJECT — CREDIT LOSSES FOR ASC 606 RECEIVABLES

In March 2025, the FASB tentatively decided to amend ASC 326 so that:

- All entities can elect a practical expedient to assume that current conditions at the balance sheet date will persist throughout the forecast period when estimating credit losses for current accounts receivable and contract assets arising from transactions accounted for under ASC 606, *Revenue from Contracts with Customers*.
- Entities other than public business entities (as defined in U.S. GAAP) that elect the practical expedient can also elect a policy to consider collection activity after the balance sheet date when estimating credit losses.

The amendments would apply prospectively and be effective for interim and annual periods beginning after December 15, 2025, with early adoption permitted. Readers should monitor the FASB website for developments.

Additionally, when a borrower experiences financial difficulty because of economic uncertainty and the entity (the creditor) modifies the borrower's contract terms, the creditor must apply the loan refinancing and restructuring guidance in ASC 310-20-35-9 through 35-11 to determine whether the modification results in a new loan or the continuation of an existing loan and make any required disclosures.

See our publication, BDO Knows CECL: The Current Expected Credit Loss Model Under ASC 326, for more information. Also, see Section 1.4.1 of this publication for more guidance on how collectibility, price concessions, and modifications of contract terms affect revenue recognition.

1.2 Investments

FASB REFERENCES

ASC 320, *Investments — Debt Securities*, ASC 321, *Investments — Equity Securities*, ASC 326-20, *Financial Instruments — Credit Losses — Measured at Amortized Cost*, and *ASC 326-30, Financial Instruments — Credit Losses — Available-for-Sale Debt Securities*

An entity is required to consider the effects of facts and circumstances that create economic uncertainty on the fair value of its investments when evaluating whether those investments are impaired. However, different impairment models apply to different types of investments.

INVESTMENT	MEASUREMENT	CONSIDERATIONS
Trading debt securities	Measured at fair value, with unrealized gains and losses recognized in earnings.	In times of economic uncertainty, the fair value of such investments may be negatively affected by factors such as: ▸ Widening credit spreads ▸ The borrower's ability to repay amounts owed ▸ Market trading prices See Section 1.5 for more guidance on estimating fair value in times of economic uncertainty.
Available-for-sale (AFS) debt securities	▸ Measured at fair value, with unrealized gains and losses recognized in other comprehensive income. ▸ Recognize allowance for credit losses. ▸ If the entity plans to sell an impaired AFS debt security or it is more than 50% likely to be required to sell the security before recovering its amortized cost basis, any credit allowance is written off and the security is adjusted down to its fair value. ▸ If the entity does not plan to sell an impaired AFS debt security, nor is it more than 50% likely to be required to sell the security before recovering its amortized cost basis, recognize any impairment attributable to credit-related factors as an allowance.	
Held-to-maturity (HTM) debt securities	▸ Measure at amortized cost. ▸ Recognize allowance for credit losses using the CECL model.	See Section 1.1 for guidance on applying the CECL model in times of economic uncertainty.
Equity securities in the scope of ASC 321	▸ **With readily determinable fair values:** generally measured at fair value each balance sheet date, with unrealized holding gains and losses (that is, changes in fair value) recognized in earnings. • Securities issued by specific entities that calculate net asset value per share (or its equivalent) are remeasured to that amount each balance sheet date, with changes recognized in earnings. ▸ **Without readily determinable fair values:** measured at either (as an accounting policy choice for each investment): • Fair value, with changes recognized in earnings • Cost minus impairment, if any (often referred to as the "ASC 321 measurement alternative")	▸ See Section 1.5 for more guidance on estimating fair value in times of economic uncertainty. ▸ Investments accounted for using the ASC 321 measurement alternative are evaluated qualitatively for impairment. Indicators of an impairment include a significant deterioration in earnings or a significant adverse change in the investee's economic environment.
Equity method investments	▸ Recognize an impairment when there is an other than temporary loss in value (remeasure to fair value).	See Section 1.2.1.

1.2.1. Classifying Debt Securities

A debt security is classified at inception and reassessed each balance sheet date. In times of economic uncertainty, an investor may need to reclassify an HTM debt security if it no longer has the intent and ability to hold securities to maturity (for example, due to a change in its liquidity). However, the sale or transfer of an HTM debt security before its maturity generally “taints” an investor's assertion with respect to other HTM securities, unless the sale or transfer is either:

- In the scope of a specific exemption in ASC 320
- Isolated, nonrecurring, unusual for the investor, **and** could not have been expected.

BDO INSIGHTS — RECLASSIFYING AN HTM DEBT SECURITY OFTEN TAINTS THE CLASSIFICATION

We believe that a transfer of an HTM debt security rarely meets all four conditions in the second exception. Accordingly, reclassifying an HTM security to trading or an AFS debt security often taints the assertion that other HTM debt securities can remain classified as such. However, reaching a conclusion requires the application of professional judgment based on the facts and circumstances.

1.2.2 Equity Method Investments

FASB REFERENCES

ASC 323, *Investments — Equity Method and Joint Ventures*

An equity method investor recognizes an impairment when there is an **other than temporary** loss in value. If there is such a loss in value, the investment is remeasured to fair value.

For an equity method investment, indicators of a loss in value include the following:

- The investee cannot sustain income (for example, it has a series of operating losses) or continue paying dividends
- A decline occurs in the investee’s near-term prospects or future income potential compared to expected performance at the acquisition date, including because of changes in facts and circumstances such as changes in technology, discontinuation of a segment, regulatory action, or loss of customers or suppliers, or uncertainty because of changes in the macroeconomic environment
- The investee’s financial condition deteriorates, as illustrated by a decrease in capital strength, liquidity crisis, downgrade in credit rating, bankruptcy, or inability to continue as a going concern
- A transaction with the investee (or an impairment recognized by the investee) confirms a loss in value
- Other investors decrease their support or commitment to the investee
- The investment’s fair value is less than its carrying amount or the investor cannot recover the investment, including due to changes in the economy, industry, or market in which the investee operates

This list is not exhaustive or determinative; all facts and circumstances are evaluated.

Some have misinterpreted ASC 323-10-35-32, which states that *“evidence of a loss in value might include… [an] absence of an ability to recover the carrying amount of the investment,”* to mean that if the investor expects to recover the investment using undiscounted cash flows, then there is no other than temporary impairment (OTTI). However, the OTTI model is based on fair value, which considers discounted, rather than undiscounted, cash flows. The SEC staff said it would object to using undiscounted cash flows as a basis for not recognizing an OTTI.[1]

[1] Paragraph 25 of the March 2004 minutes from the discussion of the EITF No. 03-1, *“The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments.”*

BDO INSIGHTS — MEANING OF "TEMPORARY" IN "OTHER THAN TEMPORARY"

ASC 323 does not define "temporary." We believe an investor should consider both:

- The length of time and extent to which the investment's fair value has been less than its carrying amount
- The investor's intent and ability to hold the investment long enough to recover its fair value

While there is no bright line, some believe that "temporary" means months. "Other than temporary" does not mean that the impairment is expected to be permanent. The SEC staff has suggested that a decline in fair value for more than a year generally is not considered temporary.[2]

We believe an investor should consistently evaluate similar fact patterns, and that the longer the period, the more evidence the investor should have to support its conclusion that the impairment is temporary.

1.3 Inventory

FASB REFERENCES

ASC 330, *Inventory*

Times of economic uncertainty often accompany (or are due to) changes in facts and circumstances that disrupt the supply chain or increase the cost of raw materials, wages, energy, or fuel costs to transport raw materials and finished goods. If sales prices and revenues do not increase correspondingly, for example, due to long-term fixed-price contracts, or due to demand decreases or price sensitivity, an entity may need to write down inventory. Events that damage inventory such as natural disasters may also result in a need to write down inventory values.

Inventory generally is measured at cost, but the specific methods used dictate how an entity measures inventory at each balance sheet date.

INVENTORY METHOD	MEASUREMENT	CONSIDERATIONS
Last in, first out (LIFO) or the retail inventory method (RIM)	Lower of cost or market.	▶ Seasonal or perishable inventory has the highest risk of impairment. ▶ An entity need not recognize a loss in an interim period when it reasonably expects to recover that loss within the same fiscal year.
First-in, first-out (FIFO), average cost, and all other methods (other than LIFO or RIM)	Lower of cost or net realizable value (NRV), which is its estimated selling price in the ordinary course of business minus reasonably predictable costs of completion, disposal, and transportation.	

[2] See Remarks by D. Douglas Alkema, Professional Accounting Fellow, SEC Office of the Chief Accountant at the 2003 Thirty-First AICPA National Conference on Current SEC Developments.

Additionally, when measuring inventory, an entity must:

- Allocate fixed overhead (for example, rent, depreciation, some fixed labor) to the cost of inventory based on “normal capacity,” which may be set as a range. However, if the entity ceases or significantly reduces production so that the actual production is below that range, the entity does not adjust the overhead allocation, but instead expenses the excess capacity (unallocated overhead) during the reporting period.
- Expense abnormal inventory costs, such as renting more storage for excess inventory, as incurred.
- Account for noncancelable, unhedged, firm commitments to buy inventory like other inventory, and evaluate them for impairment accordingly. The inventory to be received under such commitments may not be impaired when it is subject to firm sales contracts, or when other circumstances reasonably assure continuing sales without price declines. However, an entity should evaluate whether it is likely to change any related sales contract (or give a sales concession) before concluding that the inventory is not impaired. See Section 1.4 for more guidance on contract modifications and sales concessions.

Concluding on these matters requires the application of professional judgment based on the facts and circumstances.

BDO INSIGHTS — CAPITALIZING TARIFFS IN THE COST OF INVENTORY

Tariffs or other fees incurred when importing goods or raw materials for use in an entity’s fulfillment center or manufacturing facility are capitalized into inventory, consistent with ASC 330-10-30-1. An entity may not capitalize such costs into inventory if the tariff or import fee has not yet been triggered, even if it is virtually certain that a liability will arise in the future. However, since capitalizing tariffs and import fees increases the inventory’s carrying amount, an entity must also consider whether that causes the inventory to become impaired. That is, the entity must still measure inventory at the lower of cost or market (or lower of cost or NRV, as applicable) after capitalizing such costs.

1.4 Revenue Recognition

FASB REFERENCES

ASC 606, *Revenue from Contracts with Customers*

An entity applies the revenue recognition guidance in ASC 606 using the following five steps:

Step 1	Step 2	Step 3	Step 4	Step 5
Identify the contract	Identify separate performance obligations	Determine the transaction price	Allocate the transaction price to performance obligations	Recognize revenue when (or as) each performance obligation is satisfied

In times of economic uncertainty, an entity’s actions or other changes in facts and circumstances can affect its revenue recognition. For example, an entity may reevaluate its pricing and customer engagement strategies. The entity may focus on value-based pricing and bundle goods and services differently or it may offer rebates or coupons to incentivize customers to buy its products.

The following sections discuss how these and other changes in facts and circumstances in times of economic uncertainty might affect an entity's revenue recognition. However, this discussion is not exhaustive, and management should develop processes and internal controls to identify such changes and determine the accounting consequences. Our Blueprint, Revenue Recognition Under ASC 606, provides more guidance on these and other topics.

1.4.1 Step 1: Identify the Contract

Step one of the revenue recognition model is to identify the contract(s) with a customer. ASC 606 includes five criteria, which **all** must be met for a contract with a customer to exist (the contract existence criteria). If all the contract existence criteria are met, an entity accounts for the revenue from the contract using the five-step revenue recognition model in ASC 606.

One of the contract existence criteria is collectibility — it is probable that the entity will collect substantially all the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. "Probable" means that collection is likely to occur, considering the customer's ability and intent to pay, based on the facts and circumstances. This assessment includes the entity's ability to reduce its credit risk, for example by requiring prepayments or by stopping the transfer of goods or services to a customer if that customer does not pay. Such assessments may be more challenging in times of economic uncertainty.

- For **new** contracts, if collecting substantially all the consideration in the contract is **not** probable, the entity does not recognize revenue unless one of the events specified in ASC 606 occurs. See Section 2.4.2 of our Blueprint, Revenue Recognition Under ASC 606, for more guidance.
- For **existing** contracts, an entity reassesses the contract existence criteria only upon a significant change in facts and circumstances, such as severe deterioration in the customer's financial condition.
  - If a significant change has not occurred, the entity does not reassess the contract existence criteria. Instead, accounts receivable and contract assets related to that contract are evaluated for impairment in accordance with ASC 326 (see Section 1.1 of this publication).

See Sections 2.2.2 and 2.5 of our Blueprint, Revenue Recognition Under ASC 606, for more guidance on the contract existence criteria.

1.4.2 Step 2: Identify the Performance Obligations in the Contract

Step 2 of the revenue recognition model is to identify the promised goods and services in the contract and determine which of those goods and services are separate performance obligations. A performance obligation is the unit of account for recognizing revenue from the transfer of goods and services promised to a customer.

Events that cause economic uncertainty can also cause entities to change what goods or services they provide, how they provide them, and how they convey those promises in their contracts with customers, as well as their customary business practices. If an entity increases its selling prices because of higher prices, that increase is **not** a distinct performance obligation, even if the increase is a separate item on the invoice. Instead, the increase is additional consideration related to the goods and services promised in the contract (see Section 1.4.3 for more guidance).

An entity identifies performance obligations only at contract inception. In times of economic uncertainty, an entity should be alert to operational changes in the business that affect its identification of performance obligations for new contracts. See Chapter 3 of our Blueprint, Revenue Recognition Under ASC 606, for more guidance on step 2.

SURCHARGES TO CUSTOMERS FOR TARIFFS PAID BY THE ENTITY ARE NOT A PERFORMANCE OBLIGATION

If an entity charges its customers a surcharge intended to recover tariffs paid by the entity, that surcharge is additional consideration for the goods and services promised in the contract, not a distinct performance obligation.

1.4.3 Step 3: Determine the Transaction Price

Step 3 of the revenue recognition model is to determine the transaction price, which includes identifying any variable consideration and determining whether to constrain the amount of revenue recognized.

Variable consideration can arise any time the consideration fluctuates. For example, variable consideration can arise from customer incentives, such as rebates and discounts. An entity's right to pass cost increases (including tariffs) onto a customer pursuant to an existing price adjustment clause in the contract also creates variable consideration.

When the consideration promised in a contract varies, an entity estimates the variable consideration it expects to be entitled to in exchange for promised goods or services in the contract. However, the estimated variable consideration included in the transaction price is limited to the amount for which it is probable that there will not be a significant reversal of cumulative revenue recognized when the uncertainty from the variable consideration is subsequently resolved. That concept is known as the "variable consideration constraint" and is applied to each contract.

ASC 606 lists the following as factors that may increase the likelihood or the size of a revenue reversal:

- The consideration is highly susceptible to factors outside the entity's influence, including:
  - Volatility in a market
  - The judgment or actions of third parties (for example, when the consideration varies based on the customer's subsequent sales)
  - Weather conditions
  - A high risk of obsolescence of the promised good or service
- The entity:
  - Does not expect the uncertainty about the variable consideration to be resolved for a long time.
  - Has limited experience (or other evidence) with similar types of contracts, or such experience has limited predictive value.
  - Has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances.
- The contract has many possible variable consideration amounts.

An entity updates its estimated transaction price (including whether the variable consideration is constrained) based on the facts and circumstances at each balance sheet date. See Sections 4.3 and 4.8 of our Blueprint, **Revenue Recognition Under ASC 606**, for more guidance on these concepts.

In times of economic uncertainty, estimating variable consideration is often more challenging. Market uncertainty may affect an entity's estimate of the variable consideration it expects to receive, or otherwise affect the transaction price. For example, milestones or triggering events previously predicted to occur may no longer be probable. Alternatively, the entity may need to reevaluate:

- The possibility of refunding previously collected consideration.
- Its customary business practices for granting customer incentives.
- Its ability to pass on (and collect) any cost increases to which it is contractually entitled, or whether it will grant a price concession if those cost increases are significantly higher than the customer may have expected when it signed the contract.

Information relevant to estimating variable consideration sometimes becomes known or knowable between the balance sheet date and the date when the financial statements are issued or available to be issued.

BDO INSIGHTS — EFFECT OF RECOGNIZED AND NONRECOGNIZED SUBSEQUENT EVENTS ON TRANSACTION PRICE

As discussed in Section 2.1 of this publication, ASC 855, *Subsequent Events* requires an entity to distinguish between recognized and nonrecognized subsequent events. We believe that under normal circumstances, most information that becomes available related to an entity's estimate of variable consideration provides better evidence about the conditions that existed at the balance sheet date and thus is generally a recognized subsequent event that an entity reflects in its estimate of variable consideration.

For example, in the healthcare industry, payments from government programs, such as Medicare or Medicaid, are subject to regulatory review and audit. If a healthcare entity receives information from a government payor indicating that reimbursement rates will be higher or lower than expected before the financial statements are issued or available to be issued, the healthcare entity evaluates that information when assessing its estimates of variable consideration.

However, events that arise after the balance sheet date are sometimes nonrecognized subsequent events. For example, a natural disaster, an unexpected major shift in U.S. regulations, policy, or geopolitical tensions, or another discrete event that causes widespread economic uncertainty after the balance sheet date generally is a nonrecognized subsequent event that is excluded when estimating the variable consideration as of the balance sheet date.

Determining whether information obtained after the balance sheet date provides more information about the revenue to which an entity is entitled may require the application of professional judgment based on the facts and circumstances.

In times of economic uncertainty, an entity may also agree to reduce the consideration due from a customer and continue providing goods and services to that customer. In those situations, the entity determines whether it granted a price concession to its customer (which reduces the transaction price) or incurred bad debt expense.

BDO INSIGHTS — PRICE CONCESSION VERSUS CREDIT RISK

There is no specific guidance in ASC 606 on distinguishing between a price concession and an impairment of receivables. We believe that if an entity continues providing goods or services to a customer despite not collecting amounts due for previously delivered goods or services, the entity may have offered a price concession to the customer. However, this determination requires the application of professional judgment based on the facts and circumstances.

1.4.4 Step 4: Allocate the Transaction Price

After determining the transaction price for the contract in Step 3, an entity allocates the transaction price to the performance obligations identified in the contract in Step 2. ASC 606 generally requires an entity to allocate the transaction price to each performance obligation based on the relative standalone selling price (SSP) of the goods or services underlying each performance obligation. An entity allocates any changes in the transaction price to the performance obligations in the contract on the same basis as at contract inception.

If an entity changes its selling prices in times of economic uncertainty (for example, because of higher costs) it must update the SSP of its goods and services in future contracts only. That is, SSP is determined at contract inception and not reassessed for an existing contract unless the contract is modified and is accounted for as a separate contract (see Section 5.3 of our Blueprint, Revenue Recognition Under ASC 606, for more guidance).

1.4.5 Step 5: Recognize Revenue

After allocating (in Step 4) the transaction price (from Step 3) to the performance obligations identified in the contract (in Step 2), an entity determines when it satisfies each performance obligation by transferring a promised good or service to the customer and recognizes revenue allocated to each performance obligation when (or as) that performance obligation is satisfied.

Higher costs (for example, due to rapid price increases in times of economic uncertainty) may affect the percentage of revenue recognized for contracts accounted for over time. For example, an entity that uses a cost-based input method to measure progress and that cannot increase customer prices may need to increase its total expected costs, which in turn impacts the percentage of revenue to be recognized (see Sections 6.3 and 6.4 of our Blueprint, **Revenue Recognition Under ASC 606**, for more guidance).

1.4.6 Contract Modifications and Terminations

An entity may negotiate higher prices in existing contracts to reflect higher costs during times of economic uncertainty. Such changes are contract modifications and therefore, an entity must determine whether the modified contract is accounted for as a continuation of an existing contract or the creation of a new contract.

- Continuing an existing contract may result in recognizing a cumulative catch-up to revenue as of the contract modification date.
- Creating a new contract does **not** result in adjusting revenue recognized to date, but instead is accounted for prospectively.

See Section 7.3 of our Blueprint, **Revenue Recognition Under ASC 606**, for more guidance.

1.4.7 Onerous Contracts (Loss Contracts)

FASB REFERENCES

ASC 605-20, *Revenue Recognition — Services* and ASC 605-35, *Revenue Recognition — Construction-Type and Production-Type Contracts*

Costs commonly increase in times of economic uncertainty, for example, due to higher costs for raw materials, energy, and fuel, and decreased supplies of labor. When the transaction price of a contract stays flat, the potential for a loss contract arises.

ASC 605-35 applies to specific types of construction and production contracts and requires an entity to recognize a loss on the contract if the estimated costs to complete the contract exceed the total consideration the entity expects to receive. For example, this might happen if an entity cannot recover the cost increases that often occur in times of economic uncertainty. An entity must recognize the losses when the losses become evident.

ASC 605-20 has a narrow scope and includes specific guidance on losses related to extended warranty and product maintenance contracts.

See Section 7.6 of our Blueprint, **Revenue Recognition Under ASC 606**, for more guidance on loss contracts within the scope of ASC 605-35 and ASC 605-20.

BDO INSIGHTS — DIVERSITY MAY EXIST IN ACCOUNTING FOR ONEROUS CONTRACTS

Because of a lack of guidance in ASC 606 and the limited scope of ASC 605-20, accounting for onerous contracts requires the application of professional judgment based on the facts and circumstances. We believe the guidance in ASC 605-20 and ASC 605-35 applies only if the respective scope criteria are met and should not be applied by analogy. However, facts and circumstances must be evaluated, which may create diversity in practice. Expected losses related to onerous contracts that are not recognized should be disclosed.

1.4.8 Contract Costs

FASB REFERENCES

ASC 340-40, *Other Assets and Deferred Costs — Contract with Customers*

An entity recognizes incremental costs to obtain a contract as an asset in accordance with ASC 340-40 when an entity expects to recover those costs. An entity capitalizes costs to fulfill a contract (for example, direct labor, materials, and other costs chargeable to a customer) that are not in the scope of other U.S. GAAP if they relate directly to a contract, generate or enhance resources used in satisfying a performance obligation, and are expected to be recovered.

In times of economic uncertainty and changes in customer behavior from historical patterns, management may need to shorten the amortization period or revise the amortization method used for such assets (for example, straight-line may no longer be appropriate).

Additionally, changes in the macroeconomic environment may lead to an impairment of contract cost assets recognized in accordance with ASC 340-40. However, before an entity impairs an asset in the scope of ASC 340-40, it recognizes any impairment for assets related to the contract that are in the scope of other U.S. GAAP (for example, inventory, as discussed in Section 1.3 of this publication).

Then, after applying the impairment test in ASC 340-40, an entity includes the remeasured asset in the carrying amount of the asset group or reporting unit to which it belongs when testing that asset group or reporting unit for impairment in accordance with ASC 360.

See Section 7.7 of our Blueprint, [Revenue Recognition Under ASC 606], for more guidance on accounting for contract costs and Section 1.6 of this publication for more guidance on impairment of long-lived assets.

1.4.9 Disclosures

An entity should update its revenue disclosures for changes in significant judgment and estimates, including any judgments about the variable consideration it receives and the constraint on such consideration. An entity should also evaluate whether its presentation, disaggregation, and discussion of revenue are consistent in Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) and investor presentations (see Section 8.3 of our Blueprint, [Revenue Recognition Under ASC 606], and Section 3 of this publication for SEC reporting guidance). As previously discussed, an entity should disclose any expected losses related to onerous contracts that are not recognized.

1.5 Fair Value Measurements

FASB REFERENCES

ASC 820, *Fair Value Measurement*

Many areas of U.S. GAAP require fair value measurements. U.S. GAAP defines fair value as the price that would be received to sell an asset or transfer a liability in an orderly transaction between market participants at the measurement date under current market conditions. Fair value is an exit price, not an entry price. Although an exit price and an entry price are often the same, fair value is an exit price, which means that the transaction price does not necessarily represent the fair value of an asset or liability. The fair value of an asset or liability is based on the exit price in the principal market in which the entity would transact.

During times of economic uncertainty, market conditions may be under stress and may produce values that an entity may wish to disregard; however, an entity can disregard market observable values or inputs to a fair value measurement only if the transactions were not "orderly" transactions (for example, a distressed sale or liquidation) in its principal market. So, while more transactions may not be orderly in times of economic uncertainty, that does not mean all transactions during times of economic uncertainty are automatically excluded. An entity also cannot conclude that a significant decrease in the volume or level of activity in its principal market means that the transactions are not orderly. Similarly, just because an entity does not plan to sell the asset at the current transaction prices does not mean that it can exclude such information when determining the asset's fair value. Rather, reaching a conclusion about whether a transaction is other than orderly requires the application of professional judgment based on the facts and circumstances.

In addition, events that cause economic uncertainty may also affect credit risk in fair value measurements (for example, of a receivable or a derivative contract). Such events can also affect the entity's own risk of nonperformance (for example, if the entity reports its own debt at fair value).

1.5.1 Projected Financial Information and Discount Rates

When determining the fair value of an asset or liability using a discounted cash flow method, management must consider how current conditions affect the projected financial information. In times of economic uncertainty, sales might decrease, costs may go up, business strategies may change, and the transfer pricing or income taxes may also vary from the entity's historical norm or most recent projections. When determining fair value, management must update any projected financial information, growth rates, inflation rates, profit margins, estimates of capital expenditures, and other key inputs to consider inputs that market participants would use to price the asset or liability based on information that was known or knowable about conditions that existed as of the measurement date. See Section 2.1 for guidance on evaluating information that becomes known or knowable after the balance sheet date, and whether that is a recognized or nonrecognized subsequent event.

Valuation specialists often use an expected cash flow technique when determining fair value. That is, while not explicitly modelling different scenarios, the entity may be implicitly considering all known scenarios to develop a singular expected cash flow forecast. However, in times of economic uncertainty, when there is a wide range of outcomes that vary significantly from each other, it may be better to consider the use of explicit multiple cash flow scenarios to determine fair value.

The discount rate is an important input when a discounted cash flow method is used to measure the fair value of an asset or reporting unit. Interest rates, which are a key input in the discount rate, often fluctuate during times of economic uncertainty. Selecting an appropriate discount rate requires the application of professional judgment based on the facts and circumstances.

1.5.2 Disclosures About Fair Value Measurements

ASC 820 requires disclosures about an entity's recurring and nonrecurring fair value measurements. The importance of complete and transparent disclosure about fair value measurements, and the valuation techniques and inputs used increases in times of economic uncertainty. Management should take a fresh look at its disclosures about fair value measurements in times of economic uncertainty. Specifically, information about any assets or liabilities that are recognized at fair value in the current period, for example due to an impairment test, must be disclosed.

1.6 Impairment of Indefinite-Lived Assets, Long-Lived Assets, and Goodwill

In times of economic uncertainty, demand for an entity's goods and services may decrease, costs often go up, and financial markets can be volatile. Natural disasters, wars, terrorist attacks, and other events can lead to the destruction or abandonment of tangible assets. Strategic changes in response to these and other events can also change how businesses use assets and the value they provide to the entity or would provide to others.

Accordingly, an entity must determine whether to evaluate for impairment, and if so whether to recognize an impairment using the appropriate guidance for each type of asset.

The order of impairment tests is as follows:

- Assets in the scope of other U.S. GAAP (for example, receivables, as discussed in Section 1.1, investments, as discussed in Section 1.2, and inventory, as discussed in Section 1.3)
- Indefinite-lived intangible assets (see Section 1.6.1), if a triggering event exists, or at least annually
- Long-lived assets, if a triggering event exists (see Section 1.6.2)
- Goodwill, if a triggering event exists, or at least annually (see Section 1.6.2)

Our publication, **Goodwill and Impairment**, includes more guidance on the impairment models for assets in the scope of ASC 350, *Intangibles — Goodwill and Other*, and ASC 360, *Property, Plant and Equipment*. A material impairment of an asset may also require an SEC registrant to file a Form 8-K. See Section 3.5 of this publication for more guidance on SEC reporting considerations.

1.6.1 Indefinite-Lived Intangible Assets

FASB REFERENCES

ASC 350-30, *Intangibles — Goodwill and Other — General Intangibles Other Than Goodwill*

Intangible assets are indefinite lived when no factors limit their useful life. This does not mean that the assets have an infinite life, but rather that there is no limit to the assets' useful life for the foreseeable future. Tradenames, trademarks, and brands are often classified as indefinite-lived intangible assets.

An entity evaluates these assets at least **annually** for impairment, *"and more frequently if events or changes in circumstances indicate that it is more likely than not that the asset is impaired."* Such events or changes in circumstances (triggering events) include the following:

- Higher costs (such as raw materials, labor, or energy) that negatively affect future earnings and cash flows
- Deteriorating financial performance (actual or projected) due to changes in consumer demand
- Legal, regulatory, contractual, political, business, or other factors, including changes in trade policies, tariffs, or other regulations that affect the entity's business (such as changes in regulations to improve sustainability)
- Changes in management, key personnel, strategy, or customers
- Contemplation of bankruptcy, liquidation, or receivership
- Industry and market considerations, such as worsening economic environment, more competition or increased obsolescence due to changes in technology or other factors, or decreased demand
- Changes in distribution or supply channels
- Limitations on accessing capital, or changes in equity or credit markets
- Fluctuations in foreign exchange rates

Such changes in facts and circumstances are common in times of economic uncertainty and can affect the fair value of an entity's indefinite-lived intangible assets. An entity should develop processes and controls to monitor the evolving economic environment and regulatory landscape to promptly identify triggering events and determine whether it is more likely than not that an indefinite-lived intangible is impaired.

An entity may choose to qualitatively evaluate whether it is more likely than not that an indefinite-lived intangible asset is impaired. More likely than not means (in this case) a greater than 50% probability. If it is more likely than not that the asset is impaired (or if the entity does not perform the qualitative test), the entity determines the fair value of that reporting unit in accordance with ASC 820 (as discussed in Section 1.5). If the carrying amount is more than the fair value, the entity recognizes the difference as an impairment.

IMPAIRMENT TESTS DIFFER FOR INDEFINITE-LIVED VS. DEFINITE-LIVED INTANGIBLE ASSETS

Unlike the impairment test for long-lived assets discussed in Section 1.6.2, there is no recoverability (undiscounted cash flow) test for indefinite-lived assets. That is, testing indefinite-lived assets for impairment is a one-step test that considers only fair value. Accordingly, if fair value is determined using an income approach, the cash flows would be discounted.

1.6.2 Long-Lived Assets

FASB REFERENCES

ASC 360, *Property, Plant, and Equipment*

An entity evaluates long-lived assets, such as property, plant, and equipment held for use, finite-lived intangibles, and right-of-use assets recognized under ASC 842, *Leases*, for recoverability at the asset group level whenever events or circumstances indicate that the asset group's carrying amount may not be recoverable. ASC 360 defines an asset group as a group of assets and liabilities that represents **the lowest level** for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities.

The following are examples of events or changes in circumstances that may indicate that an asset's (asset group's) carrying amount is not recoverable:

- A decline in its market price due to worsening macroeconomic conditions
- A significant adverse change in the extent or manner in which it is being used or in its physical condition (for example, due to a natural disaster or the entity planning to exit a specific market or product line)
- A significant adverse change in legal factors or in the business climate that affects its value, including an adverse regulatory action (for example, an increase in tariffs on imported goods that results in reduced production abroad)
- A significantly higher cost than originally expected for acquisition or construction
- A current operating or cash flow loss combined with a history of operating or cash flow losses or forecasted future losses that demonstrate continuing losses associated with its use
- A current expectation that, more likely than not, it will be sold or otherwise disposed of significantly before the end of its previously estimated useful life ("more likely than not" refers to a more than 50% likelihood)

Such changes in facts and circumstances are common in times of economic uncertainty. If a triggering event exists for an asset (asset group) to be held and used, the impairment test is as follows:

- **Step 1: Test for Recoverability:** The entity compares the sum of the expected pre-tax undiscounted cash flows from the asset's (asset group's) use and disposal to its carrying amount.
  - If the carrying amount **exceeds** the sum of the **undiscounted cash flows**, the asset group is not recoverable, and the entity moves to Step 2.
  - If the carrying amount is **less** than the sum of the undiscounted cash flows, the asset group is recoverable, and the asset is not impaired (the analysis stops).
- **Step 2: Recognize Impairment:** The entity measures the asset's (asset group's) fair value and compares that amount to the carrying amount. The entity recognizes an impairment for the excess, thereby reducing the asset's carrying amount to its fair value.

If an entity's asset groups change (for example, due to changes in the entity's operating structure), an entity must consider whether the change in asset groups triggers an impairment test for one or more of its asset groups.

1.6.2.1 Long-Lived Assets Held for Sale

In contrast to the approach described above, if an entity decides to sell long-lived assets and the “held for sale” criteria are met, the impairment test discussed in Section 1.6.2 does not apply. Instead, the entity recognizes a loss, if applicable, to write down the disposal group to its fair value (less costs to sell). See ASC 360 for more guidance on the “held for sale” criteria.

The SEC staff addressed situations in which the difference between the disposal group’s fair value (less costs to sell) and its carrying value exceeded the carrying value of the long-lived assets in the following speech.

SEC STAFF GUIDANCE

Remarks Before the 2008 AICPA Conference on Current SEC and PCAOB Developments

Adam Brown, Professional Accounting Fellow, SEC Office of the Chief Accountant

> *The first issue deals with the impairment or disposal of long-lived assets under [ASC 360]. Consider a fact pattern in which a disposal group held for sale was established that consisted of long-lived assets in the form of property & equipment, as well as other assets such as trade receivables, and inventory. An estimate of the group's fair value, less its costs to sell, was lower than the group's carrying value. Further, the difference between the disposal group’s fair value and its carrying value exceeded the existing net book value of long-lived assets. This might lead you to a question: "Should you recognize a liability for the loss in excess of the carrying amount of the long-lived assets, and, if so, what does it represent?"*
>
> *I can think of two views for this particular fact pattern. One approach is to record the loss in excess of the carrying amount of the long-lived assets as a reduction to the carrying value of the entire group, effectively reducing trade receivables and inventory. A second approach is to limit the impairment to the carrying value of the long-lived assets in the disposal group.*
>
> *The first view interprets [ASC 360-10-35-43] to redefine the unit of account as the disposal group and to record it at the lower of its carrying amount or fair value less cost to sell. In effect, individual assets lose their identity, even though the recoverability of AR and inventory are addressed by other GAAP.*
>
> *The second view looks at [ASC 360-10-35-40], which indicates a "loss…shall adjust only the carrying amount of a long-lived asset, whether classified as held for sale individually or as part of a disposal group.” This approach would limit the loss to the carrying value of the long-lived assets. There seems to be an additional level of simplicity in the second view in that it does not result in the recognition of what, in effect, is a liability created by an asset impairment model. In addition, it appears more consistent with the change [to the current guidance from the] prior guidance which stated that “if a loss is expected from [a] proposed sale, the estimated loss should be provided for at the measurement date.” We note other applicable GAAP… provide guidance for recording liabilities. Finally, the simplicity of this view is that it also interprets [ASC 360’s] scope to address the impairment or disposal of long-lived assets, and that it isn't intended to address the recognition of liabilities.*
>
> *After considering these two views, we ultimately concluded that we would not object to either interpretation of the literature. If companies expect to incur a loss on sale in excess of the impairment associated with long-lived assets, it may be an indicator that other assets such as AR and inventory are impaired. In any event, we believe that registrants who use the first view should clearly disclose where such amounts are reflected in the financial statements and whether additional losses are expected in the future.* [Footnotes omitted.]

1.6.3 Goodwill

FASB REFERENCES

ASC 350-20, *Intangibles — Goodwill and Other — Goodwill*

Goodwill is tested for impairment at the reporting unit level at least annually, or more frequently if an event occurs or circumstances change (that is, a triggering event occurs) such that it is more likely than not that the reporting unit's fair value is less than its carrying amount.[3] The following are examples of triggering events:

- Higher costs (for raw materials, labor, or energy, for example) that negatively affect future earnings and cash flows
- Deteriorating financial performance (actual or projected) due to changes in consumer demand
- Legal, regulatory, contractual, political, business, or other factors, including changes in trade policies, tariffs, or other regulations that affect the reporting unit (such as changes in regulations to improve sustainability)
- Changes in management, key personnel, strategy, or customers
- Contemplation of bankruptcy, liquidation, or receivership
- Industry and market considerations, such as worsening economic environment, more competition, or increased obsolescence due to changes in technology or other factors, or decreased demand
- Changes in distribution or supply channels
- Limitations on accessing capital, or changes in equity or credit markets
- Fluctuations in foreign exchange rates
- **Sustained** decreases in share price (in this context, the SEC has said that registrants should consider "recent trends" in market capitalization "over a reasonable period of time"[4])

Such changes in facts and circumstances are common in times of economic uncertainty.

An entity may choose to qualitatively evaluate whether it is more likely than not that the reporting unit's carrying amount exceeds its fair value. More likely than not means (in this case) a greater than 50% probability. If it is more likely than not (or if the entity does not perform the qualitative test), the entity determines the fair value of that reporting unit in accordance with ASC 820 (as discussed in Section 1.5). If the reporting unit's carrying amount exceeds its fair value, the entity recognizes an impairment for the **lesser** of (1) that difference or (2) the goodwill in that reporting unit.

See our publication, Goodwill and Impairment, for more guidance, including on the impairment test for private companies that elect the alternative to amortize goodwill.

1.7 Income Taxes

FASB REFERENCES

ASC 740, *Income Taxes*

Recognizing reserves, accruals, and impairments also often results in recognizing book-to-tax differences when accounting for income taxes in accordance with ASC 740. For example:

---

[3] This discussion assumes that the entity has not adopted the accounting alternative for private companies to amortize goodwill. For more discussion of that alternative, see our publication, Goodwill and Impairment.

[4] See remarks of Robert G. Fox III at the 2008 AICPA National Conference on Current SEC and PCAOB Developments.

- Uncollectable receivables are deducted for tax purposes when they are "worthless." The worthlessness of a debt is a question of facts and circumstances (such as whether an event has occurred that has caused the debt to become worthless). See Section 1.1 for guidance on recognizing an allowance for credit losses under U.S. GAAP.
- In general, "normal" inventory is deducted for tax purposes when it is permanently disposed of (e.g., through selling or scrapping the goods) or when it is completely worthless. However, under IRS regulations, subnormal goods (defined as goods unsaleable at normal prices because of damage, imperfections, change of styles, etc.) are allowed to be written down to their bona fide selling price, minus direct costs of disposition. See Section 1.3 for guidance on impairing inventory under U.S. GAAP.
- Deductible goodwill is amortized for tax purposes, while goodwill generally is not amortized under U.S. GAAP, [5] but instead is evaluated for impairment (see Section 1.6 for guidance on impairing goodwill).
    - If nondeductible goodwill (for which no deferred taxes are recognized) is impaired, the entity would evaluate the impairment and determine whether to include the amount in the annual effective tax rate or as a discrete item.

Management must evaluate the realizability of its deferred tax assets (DTAs) considering all available positive and negative evidence at the balance sheet date, to determine whether to recognize a valuation allowance. For example, management should consider:

- An entity that has depended on reversing taxable temporary differences related to the book basis of intangibles with zero tax basis as a source of income to realize existing DTAs may find this source depleted from impairments.
- The effects of recent events, any actions taken by management in response (for example, restructuring), market volatility, and the resulting economic uncertainty may require management to reevaluate future taxable income projections as a source of income.
- Recent or expected cumulative losses represent significant negative evidence about the realizability of DTAs, which is difficult to overcome.

It is important to monitor changes in economic conditions and update taxable income projections throughout the year to determine whether an entity's DTAs are still realizable. An entity recognizes a change in judgment about the realizability of a DTA as a discrete event in the period that the change in judgment occurs, and not as part of the annual effective tax rate. Transparent disclosures in the notes (and MD&A, if applicable) about the realizability of DTAs are critical.

Management should also consider the following when accounting for income taxes in times of economic uncertainty:

- Changes in trade policies, tax law, organizational structure, and other facts and circumstances may affect transfer pricing studies, which may affect an entity's income tax provision.
- Management should revisit indefinite reinvestment assertions, and consider any contradictory evidence (for example, if the parent or upstream entity plans to stop or reduce manufacturing goods in foreign countries and instead manufacture domestically or to repatriate the cash to alleviate liquidity).
- Governments sometimes create new tax laws or give relief from existing tax laws in response to unexpected events that cause widespread economic harm. An entity accounts for the effects of such tax law changes in the period they are enacted as a discrete event, rather than including the effects in the annual effective tax rate. The enactment date is when all steps to become law are complete. Accordingly, the enactment date for changes to U.S. tax law generally is the date the president signs the bill into law.
- It may be more difficult for an entity to reliably estimate its annual effective tax rate in times of economic uncertainty. An entity may use the actual year-to-date effective tax rate to recognize income tax expense in interim periods during the fiscal year if significant volatility in the entity's operations prevents reliably estimating the annual effective tax rate.
    - An entity with foreign subsidiaries may need to exclude from its calculation the effective rate in an individual foreign jurisdiction if the entity cannot reliably estimate the tax rate for that jurisdiction or the foreign subsidiary has experienced or expects to experience losses for which it cannot recognize tax benefits.

---

[5] For more discussion of the private company alternative that permits amortization of goodwill, see our publication, **Goodwill and Impairment**.

1.8 Derivatives and Hedging

FASB REFERENCES

ASC 815, *Derivatives and Hedging*

Changes in the economic environment may affect an entity's accounting for derivatives and hedges. For example, changes in market conditions can lead to an instrument no longer meeting the definition of a derivative, or transactions no longer qualifying for hedge accounting.

1.8.1 Derivatives

A derivative instrument is a contract that has **all** the following characteristics:

Has one or more underlyings and one or more notional amounts or payment provisions or both + Has little or no initial net investment + Meets net settlement = Derivative Instrument

Derivatives are measured at fair value. During times of economic uncertainty, market conditions may be under stress and determining fair value might be more challenging. See Section 1.5 for more guidance on fair value measurements.

An entity must continuously reassess whether an instrument meets the definition of a derivative. Facts and circumstances may change in times of economic uncertainty, so that an instrument no longer meets the definition of a derivative. For example, an instrument may no longer meet the net settlement characteristic if a market mechanism ceases to exist or an asset to be delivered at settlement is no longer readily convertible to cash. See Section A.1 of our Blueprint, Issuer's Accounting for Complex Financial Instruments, for more guidance.

Additionally, an instrument that previously qualified for the normal purchases and normal sales (NPNS) exception (because it was probable that the instrument would result in physical delivery and not net settlement) should be reevaluated to determine whether it still qualifies for the NPNS exception. For example, after a natural disaster, an entity may conclude that physical delivery is no longer probable because management expects to cancel a transaction, or the counterparty cannot deliver the underlying. If so, the contract would no longer be eligible for the NPNS exception and is accounted for as a derivative (that is, at fair value with changes recognized in earnings).

1.8.2 Hedge Effectiveness

Initially, an entity must quantitatively assess whether a hedge is highly effective (unless the hedging relationship meets specific criteria in ASC 815). After hedge inception, the entity may quantitatively or qualitatively assess the hedge relationship's effectiveness if it meets specific conditions. Previously highly effective hedge relationships may be less effective in uncertain economic times due to higher counterparty credit risk or nonperformance risk. An entity may also need to change from qualitatively to quantitatively evaluating hedging effectiveness during times of economic uncertainty. When a hedge is no longer effective, the entity stops hedge accounting.

An entity also may change the terms of a hedged item or transaction during uncertain economic times. If the critical terms of the hedging relationship change, hedge accounting may need to be discontinued if the relationship is no longer highly effective. However, the entity may de-designate the old hedging relationship and designate the hedge item in a new hedge relationship. Conversely, if the critical terms of the hedging relationship have not changed, the entity must consider whether the hedged relationship is still highly effective. If the hedge relationship is no longer highly effective, hedge accounting stops.

1.8.3 Cash Flow Hedges

Events that cause economic uncertainty often cause supply chain disruptions and affect normal business activities. For example, a natural disaster or sudden changes in trade policies and economic conditions may cause reductions, delays, or even cancellations of transactions. If the entity previously designated these forecasted business transactions in cash flow hedging relationships, it must decide whether these transactions are still probable to continue applying hedge accounting. If the transactions are not probable and hedge accounting stops, future changes in the fair value of the derivatives are recognized in earnings. Gains and losses on the related hedges remain in accumulated other comprehensive income (AOCI) until the hedged transaction either occurs or it is probable that it will no longer occur. When the hedged transaction occurs or it is probable that it will not occur, the entity reclassifies the gains and losses on the related hedges from AOCI to earnings.

While ASC 815 includes an exception to this requirement that may apply in extenuating circumstances,[6] reaching a conclusion about whether an entity can use this exception requires the application of professional judgment based on the facts and circumstances. An entity also should consider whether the current "miss" is part of a pattern of missed forecasts that prevents the entity from using cash flow hedge accounting for similar transactions in the future.

An entity must also immediately reclassify any losses in AOCI to earnings if the entity would recognize a net loss when the forecasted transaction affects earnings. For example, if an entity has hedged a forecasted purchase of inventory and expects to recognize a net loss upon selling the inventory (because the combined cost and the deferred loss is more than the revenue from the future sale of the inventory), it immediately reclassifies the deferred loss from AOCI to earnings.

1.8.4 Fair Value Hedges

An entity may designate an unrecognized firm commitment as a hedged item in a fair value hedge. ASC 815 defines a firm commitment as a legally binding arrangement between two parties that specifies all significant terms and includes a disincentive for nonperformance. In times of economic uncertainty, the arrangement may no longer meet the definition of a firm commitment, for example, because the entity's performance is no longer probable. Therefore, an entity must immediately stop hedge accounting and reclassify the gains and losses from AOCI to earnings.

1.9 Lease Modifications, Terminations, Reassessments, and Impairments

FASB REFERENCES

ASC 842, *Leases*

An entity's lease accounting may be affected in times of economic uncertainty. For example, an entity may:

- Modify or terminate an existing lease arrangement (see Section 1.9.1)
- Receive a landlord concession, such as forgiveness of rent or delayed rent (see Section 1.9.1)
- Reassess renewal or termination options in a lease arrangement (see Section 1.9.2)
- Change how it uses leased space or equipment, which can trigger impairment (see Section 1.9.3)

This publication focuses on considerations for lessees. Lessors should refer to our Blueprint, Accounting for Leases Under ASC 842, for more guidance.

[6] See ASC 815-30-40-4.

1.9.1 Lease Modifications and Terminations

In uncertain economic times, a lessee may fully or partially terminate a lease before the lease term expires. A struggling lessee may receive concessions from the lessor, including free rent, deferred rent payments, or cash payments. A lessee must evaluate whether such a change is a lease modification or a separate contract (or neither), in accordance with ASC 842.

As defined in ASC 842, a modification is a change to the terms and conditions of a lease that results in a change in the scope of or the consideration for a lease. Whether a change is a modification or a concession in accordance with the original lease depends on the lease terms and enforceable rights and obligations of the lessee and lessor. For example, if a lease has a clause that requires rent reductions or free rent periods upon a force majeure event, then concessions received upon such an event do not represent a lease modification. A concession generally does not create a separate contract because the lessee is not granted an additional right of use (ROU).

A lessee accounts for a modification that is not a separate contract at the modification’s effective date as follows:

<table>
<tr><th>MODIFICATION</th><th>GENERAL ACCOUNTING</th><th>ADDITIONAL GUIDANCE</th></tr>
<tr><td>Grants the lessee an additional ROU not included in the original contract, and the lease payments are not commensurate with standalone price</td><td rowspan="4">▶ Remeasure the lease payments and the consideration in the contract.
▶ Reallocate the remaining consideration between the lease and nonlease components (unless the practical expedient not to separate is elected).
▶ Update the discount rate for the lease.
▶ Remeasure the lease liability.
▶ Reassess lease classification and update the subsequent accounting for the lease accordingly.</td><td rowspan="3">▶ Remeasure the lease liability by adjusting the ROU asset. However, if the carrying amount of the ROU asset is reduced to zero, the excess is generally recognized in profit or loss.
▶ If a finance lease is modified and the modified lease is classified as an operating lease, recognize as a rent prepayment or lease incentive any difference between the adjusted carrying amount of the ROU asset and the carrying amount of the ROU asset that would result from applying the initial operating ROU asset measurement guidance to the modified lease.</td></tr>
<tr><td>Extends or reduces the term of an existing lease other than through exercising an option in the original contract</td></tr>
<tr><td>Changes only the consideration in the contract</td></tr>
<tr><td>Fully or partially terminates an existing lease (for example, reduces the assets subject to the lease)</td><td>▶ Decrease the carrying amount of the ROU asset on a basis proportionate to the full or partial termination. Any difference between the reduction in lease liability and proportionate reduction in ROU asset is recognized as a gain or loss at the modification’s effective date.</td></tr>
</table>

FULL OR PARTIAL TERMINATION GUIDANCE APPLIES ONLY TO IMMEDIATE TERMINATIONS

The guidance related to full or partial terminations in the above table applies only if the right of use (or a portion thereof) **immediately** ceases at the modification’s effective date (for example, the lessee immediately returns the leased asset or immediately vacates the leased office space). If a lessee and lessor execute an amendment to terminate the lease fully or partially, but the change is effective in the future or upon a specified event, the lessee applies the guidance on lease term reductions rather than the guidance on terminations. See Section 5.8 of our Blueprint, Accounting for Leases Under ASC 842, for more guidance on a lessee’s accounting for lease modifications, including when the termination is executed concurrently with a new lease with the same lessor.

See Section 1.13 for guidance on cease-use charges incurred upon terminating a lease.

1.9.2 Lease Remeasurements

An entity may need to reevaluate the likelihood of exercising renewal and termination options during economically uncertain times.

A lessee must consider all contractual provisions in a lease when determining the lease term at the commencement date, including renewal and termination options. Only those options that the lessee is reasonably certain to exercise affect the lease's initial measurement.

A lessee reassesses the lease term or the likelihood of exercising a lessee purchase option only when:

- A significant event or a change in circumstances within the lessee's control directly affects whether the lessee is reasonably certain to exercise (or not exercise) an option
- An event specified in the contract obliges the lessee to exercise (or not exercise) an option to extend or terminate the lease
- The lessee exercises an option previously not considered reasonably certain of exercise
- The lessee does not exercise an option it previously considered reasonably certain of exercise

In a rapidly evolving economic environment, lessees must promptly identify all events requiring a lease remeasurement. The table below summarizes the accounting for lease reassessments other than modifications:

<table>
<tr><th>REMEASUREMENT EVENT</th><th>GENERAL ACCOUNTING APPLICABLE TO ALL REMEASUREMENT EVENTS</th><th>UPDATE THE DISCOUNT RATE?</th><th>REASSESS LEASE CLASSIFICATION?</th></tr>
<tr><td>A change in the lease term or the assessment of whether the lessee is reasonably certain to exercise a purchase option (see below)</td><td rowspan="3">▶ Remeasure the lease payments and the consideration in the contract
▶ Reallocate the consideration between the lease and nonlease components (the practical expedient not to separate was elected)
▶ Remeasure the lease liability by adjusting the ROU asset; however, if the carrying amount of the ROU asset is reduced to zero, recognize the remainder in profit or loss</td><td>Yes, unless the discount rate already reflects a lessee's extension, termination, or purchase option.[7]</td><td>Yes[8]</td></tr>
<tr><td>A contingency on which some or all of the variable lease payments are based is resolved, such that those payments become fixed</td><td>No</td><td>No</td></tr>
<tr><td>A change in the amount probable of being owed to the lessor under a residual value guarantee</td><td>No</td><td>No</td></tr>
</table>

See Section 5.7 of our Blueprint, Accounting for Leases Under ASC 842, for more guidance on the lessee's accounting for lease reassessments.

1.9.3 Lease Right of Use Asset Impairments

Lessees must identify indicators that an ROU asset is impaired. For example, the ROU asset related to a leased retail store may be impaired upon a decrease in the expected future cash flows from sales at that store. The ROU asset related to a leased warehouse might be impaired if the lessee's plans for using that warehouse change due to changes in its inventory or supply chain.

---

[7] When the lessee updates the discount rate, it determines the new rate at the remeasurement date based on the remaining lease term and the remaining lease payments.

[8] When the lessee reassesses lease classification, it does so based on the facts and circumstances at the reassessment date (for example, based on the fair value and remaining economic life of the underlying asset at that date).

A lessee tests an ROU asset for impairment in accordance with ASC 360 (see Section 1.6.2 of this publication and Section 5.9 of our Blueprint, [Accounting for Leases Under ASC 842], for more guidance). A lessee must also reassess the asset's useful life (for example, if the lessee plans to abandon the lease before the end of the initial lease term but the asset group is not impaired). Because plans can change quickly in times of economic uncertainty, a lessee must promptly identify triggering events requiring impairment testing.

1.10 Debt

FASB REFERENCES

ASC 470-50, *Debt — Modifications and Extinguishments* and ASC 470-60, *Debt — Troubled Debt Restructurings by Debtors*

During uncertain economic times, an entity may have less cash available for debt service. As a result, an entity may need to increase its borrowings or refinance one debt instrument with another, which would have accounting consequences as further discussed in Section 1.10.1.

An entity may also struggle to comply with financial debt covenants in a time of economic uncertainty. As a result, an entity may violate a debt covenant during the reporting period or after the balance sheet date but before the financial statements are issued or available to be issued, which may raise a question about the debt's classification as short-term or long-term debt, as discussed in Section 1.10.2.

1.10.1 Debt Modifications

If an entity pays off its original loan with proceeds from a new lender, it accounts for the extinguishment of the original loan and the new loan as a separate borrowing. However, if the debtor restructures a loan with the same lender, it must first consider the troubled debt restructuring (TDR) guidance in ASC 470-60.

- If the entity is experiencing financial difficulties and the lender provides a concession to the entity, the debt restructuring is a TDR, which may result in the recognition of a gain or loss for the difference between the fair value and the carrying amount of assets transferred. Alternatively, the borrower may adjust the effective interest rate on the restructured debt prospectively.
- If the debt restructuring is not a TDR, the debtor must determine the right accounting. For modifications or exchanges of term loans and convertible debt, the accounting depends on whether the modified debt is substantially different from the original debt.
  - If the debt instruments **are substantially different**, the transaction is accounted for as an extinguishment of the old debt and an issuance of new debt. The entity:
    - Recognizes the new debt at fair value as part of the reacquisition price.
    - Writes off the old debt and recognizes the difference between the reacquisition price and the net carrying amount of the extinguished debt as a gain or loss.
  - If the debt instruments **are not substantially different**, the change is accounted for prospectively as a modification. The entity:
    - Determines the new effective interest rate to use prospectively, based on the debt's carrying amount to the present value of the new cash flows.
    - Measures the debt at amortized cost using the new effective interest rate.
    - Does not recognize a gain or loss.

For modifications or exchanges of revolving debt arrangements, the accounting depends on whether the borrowing capacity under the revolving debt increased or decreased. See our publication, [Troubled Debt Restructuring, Debt Modification, and Extinguishment], for more guidance on TDRs, modifications, and extinguishments.

1.10.2 Debt Classification

Generally, an entity classifies a long-term obligation that is callable or will be callable because of a covenant violation at the balance sheet date as a current liability **unless any** of the following facts and circumstances exists:

- The lender granted a waiver before the financial statements are issued or are available to be issued.
- The lender later lost the right to call the debt for more than one year from the balance sheet date, for example, because:
  - The agreement includes a call period within which the lender can demand repayment, and that call right expired unexercised before the financial statements were issued or were available to be issued.
  - The entity has cured the covenant violation, and the debt is no longer callable before the financial statements are issued or are available to be issued.
- The debt has a grace period within which the entity may cure the violation, and it is probable that the entity will cure the violation within that period (therefore preventing the debt from becoming callable).
- The entity has the intent and ability to refinance the debt on a long-term basis.

BDO INSIGHTS — DEBT COVENANT VIOLATIONS OCCURRING AFTER THE BALANCE SHEET DATE

ASC 470-10-45-1 notes that long-term debt with ongoing covenant compliance requirements is classified as a noncurrent liability unless both conditions are met:

- A covenant violation allowing the lender to call the debt has occurred at the balance sheet date (or would have occurred absent a modification)
- It is probable the borrower will not comply with the covenant at measurement dates within the next 12 months.

Accordingly, a debt's classification should generally be based on the facts and circumstances existing at the balance sheet date. However, ASC 470-10-45-1 also states that noncurrent classification is appropriate unless facts and circumstances indicate otherwise, suggesting there might be situations when it may be appropriate to classify long-term debt with ongoing covenant violations as a current liability even when both conditions are not met.

Accordingly, we believe an entity must evaluate the facts and circumstances to determine if long-term debt should be classified as a current liability in situations such as the following:

- Debt was not callable at the balance sheet date but became callable subsequently because of a covenant violation after the balance sheet date and before the financial statements were issued or were available to be issued.
- Debt has an actual or known covenant violation on or before the date the financial statements are issued or are available to be issued.

Reaching a conclusion on how to classify debt with covenant violations after the balance sheet date requires the application of professional judgment based on the facts and circumstances.

When an entity is in compliance with its debt covenants at the balance sheet date and through the date the financial statements are issued or are available to be issued, the entity presents long-term debt as a noncurrent liability, unless facts and circumstances indicate otherwise. That is the case even if it is probable that the entity will violate the same or more restrictive debt covenants within one year of the balance sheet date and the lender will have a right to demand the debt's repayment at that future date. That presentation is consistent with the example in ASC 470-10-55-4 through 55-5. However, the entity must disclose the potential adverse effect of its probable covenant violations.

See Section 8.3.1.1 our Blueprint, **Issuer's Accounting for Complex Financial Instruments**, for more guidance.

1.11 Employee Benefits

Generally, an entity measures postretirement benefit plan assets and obligations at the end of the fiscal year, using assumptions and information that are known or knowable at the measurement date. However, an entity may need to remeasure its asset and obligations at an interim date if specific events occur (for example, the entity amends the plan). If such an event occurs, or when the entity updates its assumptions at the measurement date, management should take a fresh look at the inputs and assumptions used when measuring defined benefit plan obligations and other long-term employee benefits, including assumptions about the following:

- Future salary increases
- Health care cost increases
- Life expectancy of its workforce
- Market volatility and asset valuations
- Discount rate

BDO INSIGHTS — SEC REGISTRANTS SHOULD CONSIDER THE NEED FOR "EARLY WARNING" DISCLOSURES

During times of economic uncertainty, even if remeasuring an employee benefit obligation is not yet required, an SEC registrant should consider whether economic conditions necessitate early warning disclosures in its MD&A about the potential effects of such events on its employee benefit plan obligations. See Section 3.3 for more guidance.

1.11.1 One-time Termination Benefits

FASB REFERENCES

ASC 420, *Exit or Disposal Cost Obligations*

During times of economic crisis or uncertainty, an entity may develop a restructuring plan that includes involuntary employee terminations. In connection with the restructuring plan, the entity may offer one-time termination benefits to the affected employees. Such benefits are in the scope of ASC 420, **unless** paid under an ongoing benefit arrangement or a deferred compensation contract.

BDO INSIGHTS — DETERMINING WHETHER A BENEFIT ARRANGEMENT IS "ONE-TIME" OR ONGOING

If an entity has a practice of providing similar termination benefits, there is a rebuttable presumption that the entity established an ongoing benefit arrangement within the scope of other U.S. GAAP (for example, ASC 712, *Compensation — Nonretirement Postemployment Benefits*). Similarly, any enhancements to an ongoing benefit arrangement that are not limited to a specific event or period are accounted for together with the ongoing benefit arrangement.

Reaching a conclusion about whether an entity has established a practice of providing termination benefits, or whether any enhancements are part of the ongoing termination benefit or separate one-time benefits requires the application of professional judgment, based on the facts and circumstance, including:

- The existence of a written postemployment benefit plan or employee manual
- The frequency of past severance payments, formulas used, and related communications to employees
- The similarity (or lack thereof) between the previous and current benefits and formulas
- The statutory requirements (if any) to provide specific benefits to terminated employees, and whether some of the contemplated benefits are incremental to the statutory requirement.

For one-time benefits within the scope of ASC 420, ASC 420-10-25-4 states,

> *"An arrangement for one-time employee termination benefits exists at the date the plan of termination meets all of the following criteria and has been communicated to employees (referred to as the communication date):*
>
> *a. Management, having the authority to approve the action, commits to a plan of termination.*
>
> *b. The plan identifies the number of employees to be terminated, their job classifications or functions and their locations, and the expected completion date.*
>
> *c. The plan establishes the terms of the benefit arrangement, including the benefits that employees will receive upon termination (including but not limited to cash payments), in sufficient detail to enable employees to determine the type and amount of benefits they will receive if they are involuntarily terminated.*
>
> *d. Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn."*

If the criteria above are met and a communication date has occurred, the accounting for one-time termination benefits depends on whether employees must provide service beyond a minimum retention period (which is the legal notification period, or 60 days in the absence of a legal notification period) and is summarized in the table below:

SERVICE REQUIREMENT	ACCOUNTING
None, or service period does not extend beyond minimum retention period	▶ Recognize and measure liability at fair value (the discounted cash flow amount) at the **communication** date. ▶ Accrue the difference between the discounted and undiscounted liability (if material) between the communication date and the payment date. ▶ See Example 1 in ASC 420-10-55-2.
Beyond minimum retention period	▶ Measure liability initially at the communication date based on the liability's fair value as of the **termination** date, which considers assumptions about the likelihood that employees will meet the service condition. ▶ Accrue liability over the service period (adjusting estimates as needed). ▶ See Example 2 in ASC 420-10-55-2.

1.12 Share-based Payments

FASB REFERENCES

ASC 718, *Compensation — Stock Compensation*

Share-based payment awards often include a service, performance, or market condition, or a combination thereof.

An entity recognizes compensation cost for an award with only a **service condition** over the requisite service period. Acceleration of vesting upon an employee's termination without cause is also a service condition but does not affect the requisite service period until the triggering event (termination without cause) becomes probable. For example, if an award vests after four years of service or immediately upon the employee's termination without cause, the requisite service period is initially four years. The entity adjusts the requisite service period only if it becomes probable that it will terminate the employee without cause. In times of economic uncertainty, employees may be terminated more often than usual; management should develop processes and controls to identify any changes in the requisite service period.

A **performance condition** affects the vesting, exercisability, exercise price, or other factors used in measuring a share-based payment award's fair value and relates to **both**:

- Providing service or delivering goods for an explicitly or implicitly specified period
- Achieving a specified performance target related to the grantor's operations or the grantee's performance.

An entity recognizes compensation expense for an award with a performance condition when it is probable that the performance condition will be achieved and reassesses the probability of achieving the performance condition at each balance sheet date. In times of economic uncertainty, achieving performance conditions may no longer be probable (for example, due to the entity's declining financial performance or the probability of meeting sales targets). For awards for which achieving the performance condition was previously probable, but achievement is now **not** probable, the entity reverses previously recognized compensation cost in the period it makes that determination.

An entity includes a **market condition** (such as a condition related to the entity's achieving a minimum share price) in the award's grant-date fair value and recognizes compensation cost over the service period even if the market condition is not achieved (even if the share price minimum is not met).

For equity-classified awards, the measurement date is the grant date. For liability-classified awards, an entity initially measures the award at the grant-date fair value and remeasures it at fair value at balance sheet date until the award is settled. Determining the inputs in fair value measurements can be more challenging in times of economic uncertainty. For example, in times of economic uncertainty, it may be more challenging to estimate expected volatility, expected term, or expected dividends.

An entity may include an estimate of forfeitures (the awards not expected to vest during the requisite service period) when recognizing compensation cost. An entity must update its forfeiture estimates in times of economic uncertainty as new information becomes available. Depending on the facts and circumstances, some employee groups may be more likely to fulfill service conditions (for example, some employees may be less likely to quit during a recession), whereas other employee groups may be less likely to fulfill service conditions (for example, due to terminations or voluntary resignations if the working environment becomes untenable).

To incentivize employees in times when it may be more difficult for an employee to meet existing performance conditions or market conditions, an entity may modify existing share-based payment awards, for example by changing the vesting conditions to be more achievable. An entity also may modify an award's settlement terms so that its classification may change from equity-classified to liability-classified, or vice versa. The accounting for these modifications depends on a variety of factors.

See our Blueprint, [Share-based Payments Under ASC 718](), for more guidance on these topics.

1.13 Exit or Disposal Activities

FASB REFERENCES

ASC 420, *Exit or Disposal Cost Obligations*

In times of economic uncertainty, an entity may sell or stop a business line, close locations, move activities, or fundamentally reorganize its operations. Costs incurred for such activities may include:

- Involuntary termination benefits paid to employees pursuant to a one-time benefit arrangement that, in substance, is not an ongoing benefit arrangement or an individual deferred compensation contract (see Section 1.11.1)
- Costs to end a contract other than a lease (see Section 1.9.1 for guidance on lease terminations)
- Costs to combine or close facilities and move employees

ASC 420 requires that an entity recognize liabilities for exit activities at fair value in the period the liability is incurred (except for a liability for one-time employee termination benefits incurred over time, as discussed in Section 1.11.1). A liability is incurred when a transaction creates a present obligation to transfer an economic benefit. An exit or disposal plan, by itself, does not create a present obligation to others, and therefore, a commitment to such a plan, by itself, may not result in recognizing a liability.

An entity recognizes a liability for costs that it will incur during the remaining contractual term without economic benefit at fair value at the cease-use date. If fair value cannot be reasonably estimated, an entity recognizes the liability when fair value can be reasonably estimated.

Charges that are considered lease payments (whether fixed or variable) are excluded from the scope of ASC 420. Accordingly, a lessee's accounting for a cease-use charge depends on whether it elected the practical expedient not to separate lease and nonlease components (see Section 3.3.2 of our Blueprint, Accounting for Leases Under ASC 842, for more guidance on this practical expedient):

- **Lessee elected nonseparation practical expedient**: Payments for nonlease components or noncomponents (such as taxes and insurance) are all treated as lease payments (whether fixed or variable) and therefore are outside the scope of ASC 420 (see Section 1.9.1 for guidance on lease terminations).
- **Lessee did not elect nonseparation practical expedient**: Fixed payments and estimated variable payments allocable to the nonlease component (for example, common area maintenance services) are accrued at the cease-use date.

Future operating losses that management expects to incur, such as those due to a decrease in revenue, are recognized when incurred. That is, future expected operating losses do not meet the definition of a liability. However, such losses may require disclosure (see Chapter 2).

1.14 Business Interruption Insurance

FASB REFERENCES

ASC 220-30, *Income Statement — Reporting Comprehensive Income — Business Interruption Insurance*

An entity may decide to temporarily close a location when faced with a natural disaster or other event that puts human lives at risk. These closures or other events may cause lost revenue or higher costs due to serious disruptions to supply chains. The resulting losses may be covered by business interruption insurance and are accounted for separately from other insurance proceeds.

When an entity can reasonably estimate such losses and recovery is probable, the entity may recognize a receivable for the expected insurance proceeds up to the amount of the incurred losses. Given the complexity of insurance policies, these determinations can be challenging.

However, the amount recognized cannot exceed the costs incurred to date. Therefore, an entity recognizes any proceeds for lost profits as a contingent gain at the settlement date. An entity may elect a policy for how to present any business interruption insurance proceeds received in the income statement (if one has not been previously elected) if that presentation does not conflict with other U.S. GAAP. The entity should disclose the nature of the event causing business interruption losses, the total business interruption insurance recoveries recognized during the period, and where in the income statement those recoveries are classified.

1.15 Contingent Losses

FASB REFERENCES

ASC 450-20, *Contingencies — Loss Contingencies*

Legal matters or other contingency accruals may arise whenever a significant event or changes in facts and circumstances disrupt the macroeconomic environment, or in response to an entity's actions (for example, former employees may sue an entity for damages alleging wrongful termination after a mass layoff).

An entity accounts for such contingent losses consistent with other losses, which is to say that it recognizes a liability if it is probable that a loss has been incurred at the balance sheet date and the loss can be reasonably estimated. See Section 2.1 for guidance on evaluating whether information that arises after the balance sheet date is recognized or only disclosed.

1.16 Government Assistance

FASB REFERENCES

ASC 832, *Government Assistance*, ASC 835, *Interest — Imputation of Interest*, and ASC 958-605, *Not-for-Profit Entities — Revenue Recognition*

Governments sometimes provide relief to entities in response to natural disasters or other events that negatively affect specific industries or areas.

The government may provide relief by changing income tax law, in which case ASC 740 applies, as discussed in Section 1.7. However, the relief is often a grant or otherwise outside the scope of ASC 740. When ASC 740 does not apply, management must apply judgment and consider any existing accounting policies, because currently there is no specific U.S. GAAP that provides guidance for business entities on the recognition and measurement of government assistance.

If the entity does not have any existing policies for accounting for such relief, it must first consider accounting principles for similar transactions or events within a source of authoritative GAAP for that entity, and then consider nonauthoritative guidance from other sources. Management should analyze the nature and form of the government assistance as well as any conditions for receiving such assistance. Depending on the type of government assistance received, business entities may account for government grants by analogy to ASC 958-605 or International Accounting Standards 20, *Accounting for Government Grants and Disclosure of Government Assistance*. Not-for-profit entities may not analogize to IAS 20, since they are within the scope of ASC 958-605 and must apply that guidance.

If the government disburses aid through legal form debt, then ASC 470, *Debt*, may apply. However, an entity may evaluate whether such debt is forgivable, and if so, whether it is probable that it will meet the forgiveness requirements. If so, an analogy to ASC 958-605 or IAS 20 may be acceptable. If ASC 470 applies because the debt is not forgivable (or it is not probable that the entity will meet any forgiveness requirements), a business entity does not impute any interest even if the loan has a below-market interest rate, because ASC 835 excludes such loans from its scope.

While currently there is no authoritative guidance on the accounting for government grants by business entities, ASC 832 does require specific disclosures. See our Bulletin, Annual Disclosure Requirements for Business Entities Receiving Government Assistance, for more guidance.

FASB PROJECT — ACCOUNTING FOR GOVERNMENT GRANTS

In November 2024, the FASB proposed guidance on the accounting for government grants received by business entities. Readers should monitor the FASB website for developments.

1.17 Foreign Currency Matters

FASB REFERENCES

ASC 830, *Foreign Currency Matters*

In periods of economic uncertainty, foreign currency exchange rates can fluctuate significantly, which can affect financial statements as follows:

- **Foreign currency transactions**: An entity measures transactions denominated in foreign currency using its functional currency and recognizes the corresponding remeasurement gain or loss in the income statement. For example, if an entity's functional currency is the U.S. dollar but it has contracts with customers denominated in Canadian dollars, it measures these transactions in U.S. dollars using the transaction date exchange rate. Additionally, the entity remeasures any related assets and liabilities using the exchange rate at the balance sheet date. If the Canadian dollar strengthens between the transaction date and the balance sheet date, the entity recognizes a translation loss in its income statement.
  - **Intercompany transactions of a long-term investment nature:** In an exception from the guidance above, when an intercompany transaction is of a "long-term investment" nature, the entity recognizes any foreign currency gain or loss in other comprehensive income (OCI) instead of in net income. In this context, "long-term" means that the entity does not plan or expect settlement in the foreseeable future. In times of economic uncertainty and changing liquidity and cash needs or restructuring, these assertions may no longer be true, and an entity might need to **prospectively** change its accounting for such intercompany transactions (it does **not** reclassify such amounts from AOCI to income or loss).
- **Translation of foreign currency financial statements**: When a foreign subsidiary's functional currency differs from the parent's reporting currency, the parent translates the subsidiary's financial statements into its reporting currency. An entity generally uses the balance sheet date exchange rate for translating assets and liabilities and the weighted average exchange rate for the period for revenues, expenses, gains, and losses. Such translation gains and losses are recognized in OCI. These amounts stay within AOCI until the sale or substantially complete liquidation of the foreign entity (see section 1.19 for guidance on determining when a parent loses control of a subsidiary).

Although uncommon, sometimes unexpected events cause a currency to become highly inflationary. Management should remain alert for this possibility. See ASC 830 for more guidance.

1.18 Discontinued Operations

FASB REFERENCES

ASC 205-20, *Presentation of Financial Statements — Discontinued Operations*

ASC 205-20 provides guidance on presenting discontinued operations. A discontinued operation may include a component of an entity or a group of components of an entity, or a business or nonprofit activity. The required disclosures about discontinued operations vary depending on the nature of the discontinued operation. Refer to ASC 205-20 for more guidance.

1.19 Consolidation and Deconsolidation

FASB REFERENCES

ASC 810, *Consolidation* and ASC 610-20, *Other Income — Gains and Losses from the Derecognition of Nonfinancial Assets*

During times of economic uncertainty, an entity's governance or capitalization might change. One entity (or individual) might extend financial support through debt or equity funding, guarantees, or by entering into arrangements with below-market rates. Sometimes in a crisis, one entity or individual may provide implicit support (thereby taking on reputation risk) through public statements or other actions. Relationships between entities and individual can also change, creating new incentives or disincentives for entities and individuals to behave differently than they have historically.

The determination of whether one entity controls another is continuous.[9] Therefore, management should remain alert for the potential for changes in consolidation conclusions in times of economic uncertainty (that is, the potential need to consolidate a previously unconsolidated investee, or vice versa). An investee that was previously a voting interest entity might become a variable interest entity (VIE). See our Blueprint, Control and Consolidation Under ASC 810, for more guidance on identifying a controlling financial interest and the required disclosures (including when an entity has a variable interest, but is not the primary beneficiary of a VIE).

When an entity loses control of a subsidiary that meets the definition of a business (as defined in ASC 805, *Business Combinations*), it deconsolidates the subsidiary using the guidance in ASC 810. However, if the entity deconsolidates a subsidiary that consists only of nonfinancial assets (that does not meet the definition of a business) it generally applies ASC 610-20. See Appendix A of our Blueprint, Revenue Recognition Under ASC 606, for more guidance on ASC 610-20. See our Blueprint, Business Combinations Under ASC 805, for more guidance on the definition of a business.

1.20 Bankruptcy and Liquidation

FASB REFERENCES

ASC 852, *Reorganizations* and ASC 205-20, *Presentation of Financial Statements — Liquidation Basis of Accounting*

During times of economic uncertainty, an entity or one of its subsidiaries may file a plan to reorganize in accordance with Chapter 11 of the U.S. Bankruptcy Code or may liquidate in accordance with that code. ASC 852 provides guidance in the former situation. ASC 205-20 applies when the reporting entity's liquidation is imminent (as defined in that standard) unless the liquidation follows a plan specified in the entity's governing documents at the entity's inception, or unless the entity is an investment company regulated under the Investment Company Act of 1940.

When the reporting entity (parent) itself does not file for bankruptcy or liquidation, but its subsidiary does, the reporting entity (parent) must determine whether consolidation is still appropriate. See Section 6.5.2 of our Blueprint, Control and Consolidation Under ASC 810, for more guidance.

[9] Although the evaluation of whether an entity is a variable interest entity is required only upon specified events, the determination of which entity is the primary beneficiary (or parent) of a VIE (or voting interest entity) is continuous.

BDO INSIGHTS — BANKRUPTCY OR LIQUIDATION GENERALLY IS A NONADJUSTING SUBSEQUENT EVENT

When a subsidiary files for bankruptcy or liquidation after the balance sheet date, the (former) parent does not recognize that event in its consolidated financial statements as of the balance sheet date. Under ASC 810-10-40-4, a parent deconsolidates a subsidiary as of the date it ceases to have a controlling financial interest. Therefore, it is inappropriate for a parent to deconsolidate a legal entity before it has lost control. Instead, the parent discloses the loss of control after the balance sheet date as a nonrecognized subsequent event. See Section 2.1 of this publication for more guidance on subsequent events.

1.21 Oil & Gas Reserves

FASB REFERENCES

ASC 360 and ASC 932, *Extractive Activities — Oil and Gas*

Natural disasters, wars, international sanctions, increasing geopolitical tensions (particularly between oil-producing countries), tariffs, and other governmental regulations are all factors in the prices of oil and gas. Consumer behavior and supply and demand, which often fluctuate during times of economic uncertainty, also affect oil and gas prices.

Oil- and gas-producing entities may reduce their capital expenditures or be exposed to the risk of impairment. Affected entities need to reevaluate their reserve estimates, including proved undeveloped reserves. Similarly, an entity must evaluate impairment and revisit rates used to recognize depreciation, depletion, and amortization. Complete and transparent disclosure of supplemental oil and gas information is particularly important in times of economic uncertainty.

2. DISCLOSURES: CONSIDERATIONS IN TIMES OF ECONOMIC UNCERTAINTY

An entity must evaluate the completeness and transparency of its accounting, judgments, and disclosures related to the topics discussed in Section 1, as applicable. Additionally, in times of economic uncertainty, entities must consider the disclosure requirements with respect to subsequent events, risks and uncertainties, and going concern assessments.

2.1 Subsequent Events

FASB REFERENCES

ASC 855, *Subsequent Events*

Before issuing the financial statements, management must consider all available information to determine whether it provides more evidence about conditions that existed as of the balance sheet date and adjust the financial statements for this type of information (referred to as “recognized subsequent events”). However, management should not adjust the financial statements for events and conditions that did not exist as of the balance sheet date (“nonrecognized subsequent events”). If the information reflects new events or conditions, an entity must disclose the nature of the events and the potential effect on the financial statements to prevent the financial statements from being misleading. Such disclosures should be tailored to the entity’s facts and circumstances, rather than being generic.

In times of economic uncertainty, entity-specific or macroeconomic conditions can suddenly shift, and often the economic or regulatory landscape evolves. Accordingly, management must evaluate what was known (or knowable) as of the balance sheet date, and exercise caution and not rely solely on hindsight if the event is a nonrecognized subsequent event.

2.2 Risks and Uncertainties

FASB REFERENCES

ASC 275, *Risks and Uncertainties*

Entities must disclose risks and uncertainties that could significantly affect the amounts in the financial statements in the near term. Risks and uncertainties can stem from the nature of an entity's operations, the use of estimates in the financial statements, or significant concentrations in an entity's operations.

A changing economic environment may directly or indirectly affect an entity's operations. If it becomes known before the financial statements are issued that it is at least reasonably possible that significant estimates will change in the near future and the change would be material, an entity must add a disclosure to that effect. For example, if an entity determines that a sustained stock price decline that was **not** known or knowable as of the balance sheet date would be a triggering event for a material goodwill impairment in the following period, and that is known or knowable before issuing the financial statements, the entity is required to disclose that risk and potential effect.

An entity also may have concentrations that present greater risk to its financial condition or results of operations, such as customers, suppliers, geographic locations, and products. When management is aware that a concentration exists that makes the entity vulnerable to a risk of loss in the near term and it is at least reasonably possible that events or circumstances may occur that could have a severe impact in the near term, ASC 275 requires incremental disclosures. If an entity has a concentration in an activity or areas affected by economic uncertainty (for example, higher costs or canceled orders), it must disclose the potential near-term effect. These are "early-warning" disclosures that identify risk areas or known trends or uncertainties. These disclosures are similar to the SEC's requirement to discuss known trends or uncertainties within MD&A as highlighted in Section 3.3, and to the requirement to provide "early-warning" disclosures about critical accounting estimates.

BDO INSIGHTS — EVALUATE FACTS AND CIRCUMSTANCES WHEN PREPARING DISCLOSURES

More economic uncertainty may present unique risks and uncertainties and affect operations and financial statements. Management must evaluate the entity's facts and circumstances and the effects separately to determine the appropriate reporting and disclosure consequences. The SEC staff may comment on disclosures that inappropriately commingle economic uncertainty considerations into one risk, uncertainty, or effect.

2.3 Going Concern Assessments

FASB REFERENCES

ASC 205-40, *Presentation of Financial Statements — Going Concern*

U.S. GAAP requires management to assess an entity's ability to continue as a going concern for at least one year after the financial statements are issued (or available to be issued).

In times of economic uncertainty, entity-specific or macroeconomic conditions can suddenly shift, and often the economic or regulatory landscape evolves. Such rapid or significant changes in facts and circumstances may make it challenging to evaluate the effect on an entity's ability to obtain, extend, or renew credit agreements. An entity with declining financial performance may also violate its debt covenants. These types of events and conditions must be considered in an entity's going concern analysis. If conditions or events raise substantial doubt about the entity's ability to continue as a going concern, management evaluates whether its plans that are intended to mitigate those conditions and events will alleviate that substantial doubt.

An entity must disclose the following when substantial doubt exists that the entity will continue as a going concern:

DISCLOSURE REQUIREMENT IF SUBSTANTIAL DOUBT IS RAISED	NOT ALLEVIATED	WAS ALLEVIATED
▶ Disclose that substantial doubt about the entity's ability to continue as a going concern exists	Required	Not required
▶ Disclose information that enables financial statement users to understand all the following:		
• Principal conditions or events that raise substantial doubt about the entity's ability to continue as a going concern	Required	Required (before considering management's plans)
• Management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations	Required	Required
• Management's plans that are **intended to mitigate** the conditions or events that raise substantial doubt about the entity's ability to continue as a going concern	Required	Not required
• Management's plans that **alleviated** substantial doubt about the entity's ability to continue as a going concern	Not required	Required

See our publication, Going Concern Assessments, for more guidance.

3. SEC REPORTING: CONSIDERATIONS IN TIMES OF ECONOMIC UNCERTAINTY

A changing economic environment often creates new and evolving risks, uncertainties, impacts, and challenges that can affect SEC registrants' disclosures. Such disclosures may appear throughout SEC filings, including registration statements and annual, quarterly, and current reports. Transparency and specificity are important to ensure that investors understand the actual and potential impact of the economic uncertainty on the registrant.

AVOID "BOILERPLATE" DISCLOSURES

The SEC staff has often emphasized that registrants should avoid "boilerplate language" to address risks, trends, and uncertainties in filings. Registrants should also avoid describing the impact of such conditions and events as hypothetical risks when they have had an impact on the business. Disclosures should address the direct and indirect impact when they are material to understanding a registrant's results of operations and liquidity. The SEC staff has asked registrants to not only expand their discussion of market disruption-related risks, but also to address the quantitative impact and any mitigation efforts (for example, if the registrant raised prices in response to higher costs, modified contracts, or changed suppliers).

3.1 Description of Business

SEC RULES AND REGULATIONS

Regulation S-K Item 101, *Description of Business*

A registrant is required to describe its business and how it operates. It also must include a discussion of recent events, competition, regulation, and seasonality. Macroeconomic events that create uncertainty in markets may cause a registrant to change its overall strategy, operations, customer engagement strategies, or suppliers (such as where it sources its raw materials). If changes already occurred, or if the registrant plans to make changes in the future, the disclosures should address such changes.

3.2 Risk Factors

SEC RULES AND REGULATIONS

Regulation S-K Item 101, *Risk Factors*

Risk factors should include material risks that a registrant faces. Some risks may relate to the overall economy, some to the industry or geographic area in which a registrant operates, and some may be unique to the registrant. Risk factors must be specific and address economic conditions and geopolitical matters that directly affect the registrant. As macroeconomic conditions evolve in times of economic uncertainty, a registrant should assess whether there are any material changes from risk factors previously disclosed that warrant new or revised risk factors.

3.3 Management's Discussion and Analysis of Financial Condition and Results of Operations

SEC RULES AND REGULATIONS

Regulation S-K Item 103, *Management's Discussion and Analysis of Financial Condition and Results of Operations*

MD&A focuses on management's perspective on the business results. In this discussion, a registrant is required to discuss known trends and uncertainties that had, or are reasonably likely to have, a material impact on its operations. Significant unexpected economic events, and the resulting economic uncertainty, may present known trends for some registrants and may create uncertainties for other registrants. Whenever such a significant change in facts and circumstances occurs, registrants that have experienced material effects to date, or reasonably expect a material impact in the future, on their financial condition, results of operations, or liquidity due to these factors should include robust discussions of these circumstances. If liquidity is constrained, a registrant should evaluate whether its disclosures are adequate (for example, about meeting debt covenants and the need for capital).

If changing economic conditions affect a registrant's assumptions for a critical accounting estimate or may cause the estimate to change in the future, the registrant must disclose quantitative and qualitative information about such changes or the sensitivity of the critical accounting estimate. However, if changes in the economic environment have not affected the results of operations and are not currently expected to affect the registrant in the future, a registrant should consider whether to disclose that fact to preempt questions from stakeholders and the SEC staff.

CONSIDER “EARLY WARNING” DISCLOSURES

Registrants should consider whether economic conditions necessitate early warning disclosures about potential impairments or other expenses, or about the potential effects on revenues, gross margins, net income, or other financial metrics. See our publication, 2024 SEC Reporting Insights for more discussion about MD&A disclosure requirements.

3.4 Quantitative and Qualitative Disclosures About Market Risks

SEC RULES AND REGULATIONS

Regulation S-K Item 305, *Quantitative and Qualitative Disclosures About Market Risks*

An SEC registrant is required to disclose its exposure to market risks, such as interest rate risk, credit risk, foreign currency risk, and commodity price risk, and how the registrant manages these risks. Registrants should consider disclosing how market disruptions are affecting the registrant, and how they are managing these risks.

3.5 Current Reports on Form 8-K

SEC RULES AND REGULATIONS

Form 8-K Requirements

Registrants may need to disclose material information related to events or changes in facts and circumstances during times of economic uncertainty in a Form 8-K. For example, a registrant needs to consider whether to disclose the following on Form 8-K:

- **Entry into, or modification of, a material definitive arrangement with a supplier or customer that was not made in the ordinary course of business:** Reported under Item 1.01 of Form 8-K.
- **Termination of a material definitive arrangement with a supplier or a customer that was not made in the ordinary course of business:** Reported under Item 1.02 of Form 8-K.
- **A material impairment triggered by an increase in costs or a decline in demand:** Such impairments generally must be reported within four business days under Item 2.06 of Form 8-K, unless the conclusion is made in connection with the preparation, review, or audit of financial statements required to be included in a timely filing and such disclosure is included in the timely filed report.
- **Costs related to exit or disposal activities**: Reported under Item 2.05 of Form 8-K.
- **Liquidity issues that trigger the violation of debt covenants or the acceleration of obligations**: Reported under Item 2.04 of Form 8-K.

3.6 Non-GAAP Financial Measures

SEC STAFF GUIDANCE

Regulation G, Item 10(e) of Regulation S-K. and SEC Compliance and Disclosure Interpretations, Section 100

SEC registrants should be mindful of the SEC's rules, regulations, and guidance when adjusting and presenting non-GAAP financial measures. Registrants are required to explain why such measures are useful to investors and consider whether they are consistent with measures used by management and communicated to the board. Registrants should also keep in mind the following SEC requirements on non-GAAP measures:

- **Adjustments for costs that are normal, recurring, cash operating expenses relative to a registrant's operations are not allowed.** An operating expense that is normal, recurring, **or** cash may be considered a normal, recurring, cash operating expense (in other words, the operating expense does **not** need to be all three). For example, write-downs for excess or obsolete inventory are not cash operating expenses, but are still considered normal, recurring, cash operating expenses.
- **Adjusting the measurement or recognition principles of U.S. GAAP is not allowed.** Changing the accounting for variable consideration due from a customer related to higher costs, removing accelerated depreciation from measures other than EBITDA, and reversing the effects of purchase accounting after the acquisition date are all examples of individually tailored accounting principles.

However, a registrant **may** disclose and quantify the effects of economic events in one place and separately list those effects without adjusting its GAAP results. For example, a registrant may include a supplemental table that describes each item and includes dollar amounts. While the non-GAAP rules and SEC staff guidance do not apply to such supplemental information, a registrant that presents such a table should consider explaining how and why this information can help investors analyze the registrant's results.

Evaluating whether adjustments to non-GAAP measures comply with the SEC regulations may require significant judgment. See our publication, SEC Updates Compliance and Disclosure Interpretations on Non-GAAP Financial Measures, for more guidance.

3.7 SEC Staff Disclosure Guidance in Times of Economic Uncertainty

In times of economic uncertainty, the SEC staff in the Division of Corporation Finance may issue disclosure guidance or sample comment letters to remind registrants about SEC reporting requirements that may be particularly relevant in that moment, depending on the nature of the event that occurred. For example, the SEC staff did so during the COVID pandemic and in response to Russia's invasion of Ukraine.[10] A common theme in this guidance is the importance of providing detailed disclosures, as applicable and if material, of any direct or indirect exposure to the event or trends causing disruptions in the market.

While not an exhaustive list, such disclosures may include:

- Exposure with respect to employees, investments, or reliance on goods or services sourced from affected areas
- Operational adjustments to protect employees or customers, and both the short-term and long-term effects on financial performance and liquidity
- Actual or potential disruptions in an entity's supply chain
- Business relationships or material assets located in the affected areas
- New known trends or uncertainties

[10] See our publication, SEC Staff Sample Comment Letter on Disclosures Regarding Russia's Invasion of Ukraine, and the SEC Staff's Disclosure Guidance, Coronavirus (COVID-19); Disclosure Considerations Regarding Operations, Liquidity, and Capital Resources.

- Novel terms or structures used for financing (for example, changes in credit facilities, lines of credit, supplier finance, customer payment terms) or short-term usage of deferrals, forbearance periods, or other concessions
- Changes in capital expenditures (for example, in response to a specific event or to manage liquidity)
- Changes in share repurchase programs or dividend payments
- Changes to critical accounting estimates
- Changes in exposure to income taxes, including whether the registrant is taking advantage of any tax relief (see Section 1.7 for more guidance)
- Changes in reliance on governmental assistance (see Section 1.16 for more guidance)
- Risks related to cybersecurity
- Changes in disclosure controls and procedures or internal controls over financial reporting (see Section 4)

The SEC staff also often remind registrants in times of economic uncertainty not to adjust for estimated lost revenue or exclude normal, recurring cash operating expenses when presenting non-GAAP financial measures (see Section 3.6).

4. INTERNAL CONTROLS OVER FINANCIAL REPORTING: CONSIDERATIONS IN TIMES OF ECONOMIC UNCERTAINTY

Management must consider how economic uncertainty may affect the entity's financial statements and its internal controls over financial reporting (ICFR). Effective internal controls help entities comply with regulations, manage their financial impact, and optimize supply chain strategies to mitigate economic uncertainty. Consequently, management may need to design and implement new controls or modify existing ones to address the complexities and risks associated with events that cause economic uncertainty. This could involve revising controls over estimation processes, particularly for estimates related to future cash flows. Management should not rely excessively on historical information and include only information that was known or knowable as of the measurement date. Management should reevaluate whether the thresholds used for past sensitivity analyses remain appropriate and consider contrary evidence. For example, an entity may need a more detailed process than previously used for estimating variable consideration for cost increases passed through to customers.

SEC registrants also must evaluate whether they have made any changes to the design of their ICFR that have materially affected, or are reasonably likely to materially affect, their ICFR. If so, a registrant must disclose such changes in its Form 10-Q or Form 10-K.

5. AUDITING: CONSIDERATIONS IN TIMES OF ECONOMIC UNCERTAINTY

Audits play a vital role in underpinning, and providing confidence in, financial information about the businesses and institutions in our economies.

Even during times of economic uncertainty, auditors need to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level. In such an environment, there may be heightened and new risks of material misstatement or more difficulty in obtaining sufficient appropriate audit evidence. The guidance below sets out possible implications and suggests potential responses that audit committees and management should factor into the oversight and execution of financial reporting.

5.1 Financial Reporting Risks

Auditors need to understand how economic uncertainty may affect the entity and adjust their audit plans accordingly. For example, auditors should consider the following questions:

- Have higher costs adversely affected the entity's cash flow projections or performance?
- Does the entity operate in an industry directly or indirectly affected by the event causing the economic uncertainty?
- Has resource scarcity affected the entity's manufacturing processes or supply chains?
- Have economic events introduced additional going concern risks or affected management plans and assumptions, leading to cash flow issues?
- Does economic uncertainty create more pressures that increase or add fraud risks?
- Does the entity depend on customers or suppliers affected by the events causing the economic uncertainty?

- Are there any contractual arrangements where performance or terms may be affected by economic uncertainty, such as an inability to meet contract terms or fixed contract prices, resulting in poorer returns?

As discussed in Sections 1 and 2, there may be heightened risks of misstatement in specific accounting and disclosure areas, including revenue recognition, measurement of assets, impairment, and subsequent events. Management should be aware of the potential financial reporting risks for each account or disclosure area as the entity's specific situation and the macroeconomic environment evolve.

Auditors also must consider the effects of such events and economic uncertainty on the entity's control environment and internal controls over financial reporting (as discussed in Section 4).

5.2 Audit Evidence

The auditors' responsibility to obtain sufficient and appropriate audit evidence when addressing the risk of material misstatement, including those related to accounting estimates, remains unchanged in times of economic uncertainty. Auditors must still adhere to auditing standards (PCAOB or U.S. GAAS), exercise appropriate levels of professional skepticism, and apply professional judgment in evaluating the sufficiency and appropriateness of audit evidence, including evidence related to accounting estimates.

Economic uncertainty introduces more complexity, new risks of material misstatement, and may result in adjusting the nature, timing, and extent of audit procedures. These adjustments may increase effort and cost. For example, an auditor may need to:

- Adjust the planned reliance on analytical review procedures to reflect changes in facts and circumstances affecting the entity.
- Reconsider the benchmarks and percentages used to determine materiality.
- Evaluate whether assumptions in estimates and projections have been appropriately updated to include information known or knowable as of the measurement date (see Section 2.1 for more discussion of subsequent events).
- Obtain more input from valuation and other experts.
- Increase the time required to discuss, review, and challenge management estimates, calculations, and provisions.

5.3 Audit Report

As discussed in Section 2, U.S. GAAP requires entities to disclose significant risks and uncertainties, subsequent events, and conditions that raise substantial doubt that the entity will continue as a going concern, in addition to specific disclosures related to accounts or line items in the financial statements, such as revenue recognition or goodwill impairments.

In audits performed in accordance with PCAOB standards, auditors communicate Critical Audit Matters (CAMs). A CAM is any matter arising from the financial statement audit that was communicated or required to be communicated to the audit committee and that relates to material accounts or disclosures involving especially challenging, subjective, or complex auditor judgment. The effects of economic uncertainty on the entity's financial statements and disclosures may lead auditors to identify new CAMs or revise disclosures related to previously identified CAMs.

In audits performed in accordance with U.S. GAAS, auditors may consider it necessary to draw users' attention to these disclosures by emphasizing the significant uncertainties or unusually important subsequent events in the auditor's report through an "emphasis paragraph." An emphasis paragraph refers to information already presented or disclosed in the financial statements. The decision to include an emphasis paragraph depends on the auditor's assessment of the entity's facts and circumstances; specifically, whether there is a material uncertainty significant enough to affect users' understanding of the financial statements, thus warranting an emphasis paragraph in the auditor's report to highlight that disclosure. An emphasis paragraph does not modify the auditor's opinion; it merely draws users' attention to the disclosure. Sometimes, the need to include an emphasis paragraph is clear; in other cases, it is a matter of professional judgment.

6. CORPORATE GOVERNANCE: CONSIDERATIONS IN TIMES OF ECONOMIC UNCERTAINTY

In times of economic uncertainty, boards and audit committees should work closely with management, auditors, and advisors to evaluate risks and form meaningful responses to those risks. Shareholders may have heightened interest in how executives are managing significant challenges and risks related to events that create economic uncertainty, including how the entity is managing the effects of any events on its employees, customers, and supply chain, including how executives are planning for contingencies. Timely and frequent communications are more important in times of economic uncertainty.

6.1 Audit Committee Oversight

Audit committees should proactively oversee the financial reporting and disclosure process, including internal controls over financial reporting. Events that create economic uncertainty present unique challenges and risks for each entity. Audit committees should consider the following questions as they engage with management and the auditors:

- Do the financial statement disclosures reflect changing risk factors, such as changes in supply chains, pricing decisions, loss of significant customers, and disruptions to production?
- Are the entity’s financial systems able to adequately capture detailed financial information related to the events driving the economic uncertainty (for example, changing tariffs information, or losses due to a natural disaster)?
- Do the financial statement disclosures reflect subsequent events that were known or knowable before issuing the financial statements (see Section 2.1) that users of financial statements will find meaningful and reflective of industry-specific considerations?
- How has management considered the economic uncertainty in its estimates, assumptions, and judgments? What changes were made and what was considered?
- Are controls over financial reporting adequate to respond to the effects of economic uncertainty, including the risk of fraud?
- Will financial statement deadlines be affected by changes to procedures performed by the entity, its specialists, or the auditors?
- Is the committee meeting often enough with management and the auditors to address challenges as they arise?
- Is management’s disclosure committee meeting often enough to ensure timely and transparent disclosures?
- Is the audit committee keeping the board apprised of significant matters with respect to risk and disclosures?

6.2 Shareholder Questions

Particularly during proxy season and annual shareholder meetings, boards should expect questions about the following:

- Risk assessment, expected effects, and response to economic uncertainty (for example, due to changes in product procurement, customer demand, or potential tariff exposure)
- Fiscal management and liquidity
- Adequacy of financial reporting and disclosures to convey risk
- Ability to provide timely public financial information
- Industry-specific risk mitigation plans (for example, contracts, supply chain, technology)

Other matters for board consideration include:

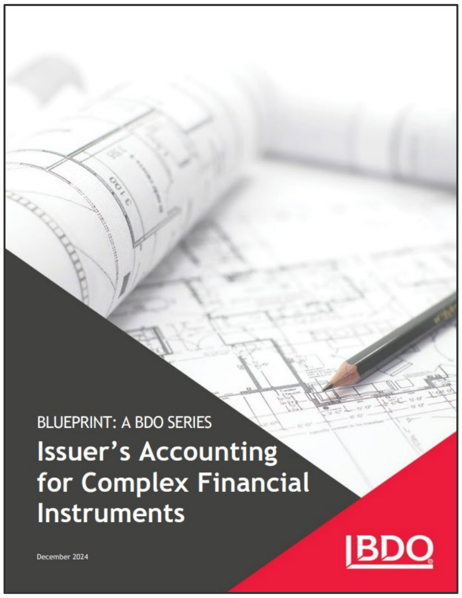
- Communicating to employees and those charged with governance that they are expected to adhere to insider trading policies
- Determining whether additional trading restrictions are warranted
- Monitoring the appropriateness of trading activities of board members and employees.

Boards — working alongside management, public relations, human resources, and counsel — need to be thoughtful and proactive in issuing timely, robust, and transparent communications to all stakeholders, particularly as developments arise. Securing the confidence of stakeholders, particularly during times of economic uncertainty, is paramount.

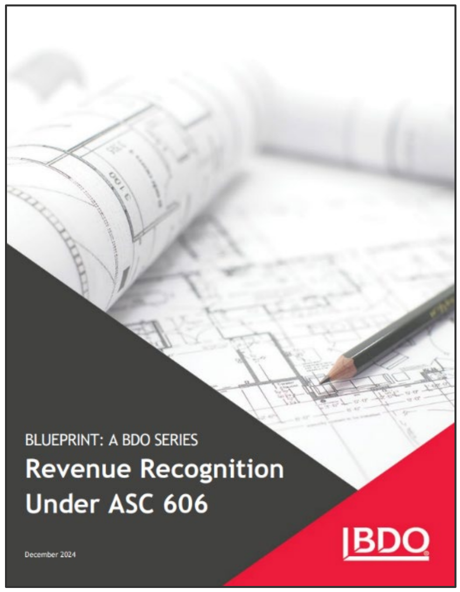
For our latest publications in times of economic uncertainty, refer to the **BDO Center for Corporate Governance**.

Appendix A — BDO Blueprints

BDO’s Blueprints and other publications are available on [BDO's ARCH].

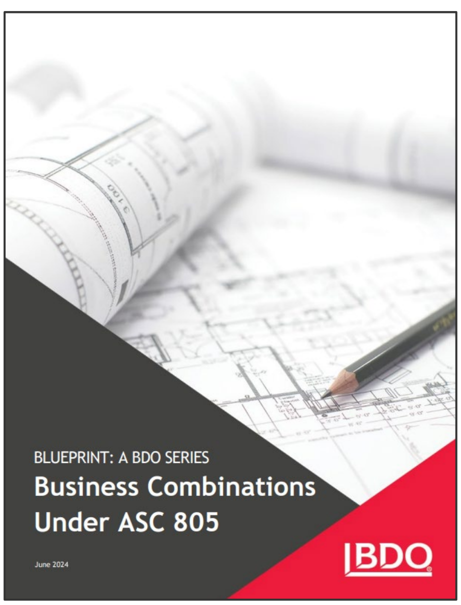


[Issuer’s Accounting for Complex Financial Instruments]

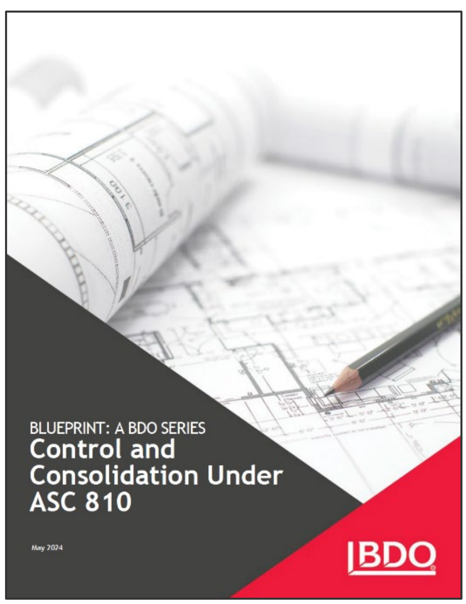


[Revenue Recognition Under ASC 606]

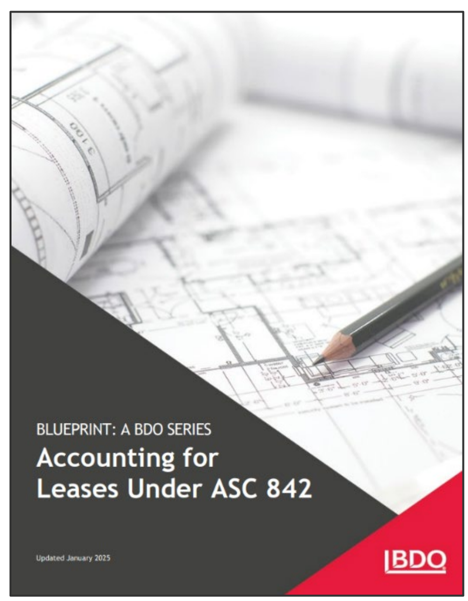
[Share-based Payments Under ASC 718]



[Business Combinations Under ASC 805]



[Control and Consolidation Under ASC 810]



[Accounting for Leases Under ASC 842]

CONTACTS

Accounting

ADAM BROWN
National Managing Principal - Accounting
214-665-0673 / **abrown@bdo.com**

ANGELA NEWELL
Professional Practice Principal — Accounting
214-689-5669 / **ajnewell@bdo.com**

MEREDITH TAYLOR
Professional Practice Principal — Accounting
571-461-6744 / **mltaylor@bdo.com**

SEC Services

TIMOTHY KVIZ
National Managing Principal - SEC Services
703-245-8685 / **tkviz@bdo.com**

PAULA HAMRIC
Professional Practice Principal - SEC Services
312-616-3947 / **phamric@bdo.com**

Assurance

ROB THORNTON
National Managing Principal - Audit Policy, Methodology and Learning
713-561-6515 / rthornton@bdo.com

KYLE SEWELL
Assurance Assistant Technical Principal
404-826-9768 / **ksewell@bdo.com**

Corporate Governance

AMY ROJIK
National Managing Principal - Corporate Governance
617-239-7005 / **arojik@bdo.com**

Valuation & Capital Markets

AUSTIN LEE
Practice Leader Principal — Valuation & Capital Markets Analysis
310-557-7590 / **austin.lee@bdo.com**

Our purpose is helping people thrive, every day. Together, we are focused on delivering exceptional and sustainable outcomes — for our people, our clients and our communities. BDO is proud to be an ESOP company, reflecting a culture that puts people first. BDO professionals provide assurance, tax and advisory services for a diverse range of clients across the U.S. and in over 160 countries through our global organization.

BDO is the brand name for the BDO network and for each of the BDO Member Firms. BDO USA, P.C., a Virginia professional corporation, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. For more information, visit: www.bdo.com.