AICPA

Special Report
March 18, 2020

Center for Plain English Accounting
AICPA's National A&A Resource Center

Consequences of COVID-19
Financial Reporting Considerations

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The coronavirus pandemic (COVID-19) is above all a global human tragedy. The spread of the pandemic also is having serious economic implications. Numerous sectors of the economy are suffering damage and the long-term economic and business consequences remain unknown. Among the many consequences of COVID-19, entities may face financial reporting implications and challenges. Impacts such as business and production disruptions, supply-chain interruptions, negative impacts on customers, volatility in the equity and debt markets, reduced revenue and cash flows, and other economic consequences may occur. This Special Report provides succinct reminders to practitioners about some financial reporting matters that may need to be considered in light of the pandemic.

Subsequent Events

Entities may need to evaluate whether the consequences of COVID-19 represent subsequent events. FASB *Accounting Standards Codification* (FASB ASC) 855, *Subsequent Events*, defines subsequent events as events or transactions that occur after the balance sheet date but before financial statements are issued or are available to be issued[1]. There are two types of subsequent events:

- The first type consists of events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the

[1] FASB ASC 855 requires that, when a reporting entity meets either of the following criteria, subsequent events need to be evaluated through the date that the financial statements are issued:
- The reporting entity is an SEC filer
- The reporting entity is a conduit bond obligor for conduit debt securities that are traded in a public market

When a reporting entity does not meet either of the above-noted criteria (e.g., typical private company), subsequent events need to be evaluated through the date that the financial statements are available to be issued.

estimates inherent in the process of preparing financial statements (that is, recognized subsequent events)

- The second type consists of events that provide evidence about conditions that did not exist at the date of the balance sheet but arose subsequent to that date (that is, nonrecognized subsequent events)

Recognized and nonrecognized subsequent events, as defined in FASB ASC 855, correspond to the two types of subsequent events described in U.S. generally accepted auditing standards (U.S. GAAS) found in AU-C 560, *Subsequent Events and Subsequently Discovered Facts*. Those two types of subsequent events are:

- Events that provide evidence of conditions that existed at the date of the financial statements (historically referred to as Type I subsequent events)
- Events that provide evidence of conditions that arose after the date of the financial statements (historically referred to as Type II subsequent events)

Practice Note: For calendar year end 2019 financial statements, any COVID-19 related subsequent events identified likely are to be nonrecognized subsequent events (Type II).

Some nonrecognized subsequent events may be of such a nature that financial statement disclosure is required to keep the statements from being misleading. In these situations, financial statements need to include disclosure of the following:

- The nature of the event or events
- An estimate of the financial statement effect of the event or events, or a statement that the estimate cannot be made

Occasionally such an event may be so significant that disclosure can best be made by supplementing the historical financial statements with pro forma financial data giving effect to the event as if it had occurred on the date of the balance sheet. It may be desirable to present pro forma statements, usually a balance sheet only, in columnar form on the face of the historical statements.

Subsequent Events- Market-Value Declines

Given the recent stock market volatility, we wanted to remind practitioners of the guidance in AICPA Technical Question & Answer (TQA) 9070.06:

TQA 9070.06

Decline in Market Value of Assets Subsequent to the Balance Sheet Date

Inquiry—In light of overall market decline, should the decline in market value of an asset subsequent to the balance sheet date result in the adjustment of the financial statements?

Reply—FASB ASC 855-10-25-1 states that "[a]n entity shall recognize in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements."

FASB ASC 855-10-25-3 states that "[a]n entity shall not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date but before financial statements are issued or are available to be issued."

FASB ASC 855-10-55-2 provides a list of examples of nonrecognized subsequent events, including changes in the fair value of assets or liabilities (financial or nonfinancial) after the balance sheet date but before financial statements are issued or are available to be issued.

Practitioners should also be aware that the amendments in ASU 2016-01, *Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income (thereby eliminating the presentation of changes in the fair value of an equity investment in other comprehensive income).

In our experience, most entities do not choose to make financial statement disclosures that are general business risks or are broadly impactful to the majority of entities, such as volatility in the stock market. For example, most non-public entities do not make financial statement disclosures regarding potential changes in value of recognized assets and liabilities due to future potential risks related to climate change, the outcome of elections, or changes in government policy. We also looked through each 10-K filed between March 9th and 16th, 2020 and noted none of them specifically mentioned the most recent decline in the stock market in their MD&A. Instead, they all included boilerplate language about risk of declines in market values of investments.

As a result, while it is ultimately up to your individual clients if they want to include something in the financial statement disclosures specific to recent stock market volatility, our position is that such a disclosure should generally not be necessary if general disclosures related to market risks are already included in the notes to the financial statements.

Subsequent Events- COVID-19

In reviewing the 10-Ks filed in the middle of March 2020, we noted that more entities are not only discussing the impact of COVID-19 within the MD&A portions of their filing, but also making disclosures within the financial statements themselves, such as the following examples

Actual Subsequent Event Disclosure – Chico's (March 2020 10-K)

In recent days, the COVID-19 outbreak in the United States has resulted in reduced customer traffic and the temporary reduction of operating hours for our stores as well as temporary store closures where government mandated. These recent developments are expected to result in lower sales and gross margin than provided in our previous outlook.

Actual Subsequent Event Disclosure – BankCorp (March 2020 10-K)

The Company evaluated its December 31, 2019 consolidated financial statements for subsequent events through the date the consolidated financial statements were issued. As a result of the spread of the COVID-19 coronavirus, economic uncertainties have arisen which are likely to negatively impact net interest income. Other financial impact could occur though such potential impact is unknown at this time.

Actual Subsequent Event Disclosure – New Age Beverage Corporation (March 2020 10-K)

In December 2019, a novel strain of coronavirus was reported to have surfaced in China. The spread of this virus began to cause some business disruption through reduced net revenue in the Company's Asia Pacific market in January and February 2020. While the disruption is currently expected to be temporary, there is considerable uncertainty around the duration. Therefore, while the Company expects this matter to negatively impact its operating results. However, the related financial impact and duration cannot be reasonably estimated at this time.

Actual Disclosure – Cambridge Bancorp (March 2020 10-K)

In December 2019, a novel strain of coronavirus was reported in Wuhan, China. The World Health Organization has declared the outbreak to constitute a “Public Health Emergency of International Concern.” The COVID-19 outbreak is disrupting supply chains and affecting production and sales across a range of industries. The extent of the impact of COVID-19 on our operational and financial performance will depend on certain developments, including the duration and spread of the outbreak, impact on our customers, employees and vendors all of which are uncertain and cannot be predicted. At this point, the extent to which COVID-19 may impact our financial condition or results of operations is uncertain.

Illustrative Subsequent Event Disclosure – Daycare Center

The COVID-19 outbreak in the United States has caused business disruption through mandated and voluntary closings of multiple daycare centers. While the disruption is currently expected to be temporary, there is considerable uncertainty around the duration of the closings. Therefore, the Company expects this matter to negatively impact its operating results. However, the related financial impact and duration cannot be reasonably estimated at this time.

Accounting Estimates

The assumptions and data supporting certain accounting estimates may be affected by the consequences of COVID-19. Practitioners should evaluate whether judgments and decisions made by management in making accounting estimates remain reasonable, in light of any economic and business developments. AU-C 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, addresses auditor responsibilities related to accounting estimates and disclosures in financial statement audits.

Asset Impairment

The consequences of COVID-19 may cause asset impairments for some entities. Impairment models under U.S. generally accepted accounting principles (U.S. GAAP) vary depending on the asset subject to the impairment test. Impairment models consideration of future events also vary significantly under current U.S. GAAP. This can even be the case for the same asset- for example a financial asset using the “incurred loss” model for impairment vs. a financial asset using the current expected credit losses model. Asset impairment considerations (and the related professional guidance for reference) may include:

- Financing receivables (e.g., trade accounts receivables, loans)
  - FASB *Accounting Standards Codification* (FASB ASC) 310, *Receivables*
  - FASB ASC 326, *Financial Instruments — Credit Losses* (if adopted)
- Inventories
  - FASB ASC 330, *Inventory*
- Contract assets
  - FASB ASC 310
- Equity securities
  - FASB ASC 320, *Investments: Debt and Equity Securities*, or FASB ASC 321, *Investments: Equity Securities*, if ASU 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, has been adopted
- Debt securities
  - FASB ASC 320 or FASB ASC 326, if ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, has been adopted
- Other investments
  - FASB ASC 325, *Investments — Other*
- Property, plant, and equipment
  - FASB ASC 360, *Property, Plant, and Equipment*.
- Intangibles
  - FASB ASC 350, *Intangibles—Goodwill and Other*
- Deferred tax assets
  - FASB ASC 740, *Income Taxes*

<u>Loss Contingencies</u>

FASB ASC 450-20, *Loss Contingencies*, may need to be considered due to the effects of COVID-19. After the date of an entity's financial statements but before those financial statements are issued or are available to be issued (as discussed in FASB ASC 855-10-25), information may become available indicating that an asset was impaired or a liability was incurred after the date of the financial statements or that there is at least a reasonable possibility that an asset was impaired or a liability was incurred after that date. If the underlying causal event did not occur before the balance-sheet date, an accrual should not be made; however, disclosures may be required, as indicated in FABS ASC 450-20-50-9. Such disclosures should include the nature of the contingency and an estimate of the possible loss or range of loss or a statement that such an estimate cannot be made.

Practice Note: These determinations are frequently difficult to make and require an informed judgment by management based on the best information available before the issuance of the financial statements. Nevertheless, entities will need to evaluate whether it is reasonably possible that a contingent loss has resulted from the consequences of COVID-19 and make any necessary disclosures.

Going Concern

The ability of an entity to continue as a going concern is affected by many factors, to include the industry and geographic area in which the entity operates, the financial health of customers and suppliers of the entity, and the accessibility to financing that is available for the entity. The consequences of COVID-19 may impact those factors and may cause a deterioration in an entity's operating results and financial position. As such, entities and practitioners may need to consider recent pertinent information related to their assessments of going concern.

An auditor's responsibilities related to going concern are included in AU-C 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*. For review engagements, the accountant's responsibilities related to going concern are included in AR-C 90, *Review Engagements*. Accountants performing compilations can refer to paragraph A20 of AR-C 80, *Compilation Engagements*, for considerations about going concern issues. U.S. GAAP guidance is contained in FASB ASC 205-40, *Disclosures of Uncertainties About an Entity's Ability to Continue as a Going Concern*. Also, see the following CPEA reports related to going concern:

- SAS No. 132: Auditing Guidance Related to Going Concern
- SSARS No. 24: New Going Concern Responsibilities in Reviews and Other Changes
- Going Concern Codified Into U.S. GAAP: New Challenges for a Delicate Process

Practice Note: Under AU-C 570 and in AR-C 90, the period of time that an auditor needs to consider related to a going concern assessment is the period of time required by the applicable financial reporting framework or, if no such requirement exists, within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable). The look forward period in U.S. GAAP matches the look forward period in AU-C 570 and AR-C 90: one year from the financial statement issuance date (or at the date that the financial statements are available to be issued, when applicable).

CPEA Observation**:** The look-forward period is one year from the date the financial statements are issued. With circumstances changing hourly due to COVID-19 with severe impacts in some industries (restaurants, entertainment, airlines, etc.), making the required projections to determine substantial doubt about the ability to continue as a going concern under U.S. GAAP in some cases could be extremely difficult. It may be advisable to delay statement issuance, if possible, in these cases until projections can be made.

Actual Going Concern Disclosure – Cineworld (international movie chain) (March 2020 annual report)

…the Group continues to adopt the going concern basis in preparing its Consolidated Financial Statements.

The uncertainty as to the future impact on the Group of the recent COVID-19 outbreak has been considered as part of the Group's adoption of the going concern basis. Thus far, we have not observed any material impact on our movie theatre admissions due to COVID-19. Following an increase in admissions in the first two months of the year against the same period in the previous year, we continue to see good levels of admissions in all our territories, despite the reported spread of COVID-19. Although the release of the new Bond movie has been postponed to November 2020 largely due to closure of cinemas in the Asian markets, the studios have advised us that in the countries in which we operate, they currently remain committed to their release schedule for the coming months and remainder of the year.

In the downside scenario analysis performed, the Board has considered the potential impact of the COVID-19 outbreak on the Group's results. In preparing this analysis the following key assumptions were used: the impact of a total loss of revenue across the enlarged estate for between one and three months, no fixed costs reductions should sites be closed, run-rate combination benefits of c.$133m expected to be achieved as part of the Cineplex acquisition, forecast capital expenditure reduced in 2020 by 90%, and cessation of dividend payments from 1 July 2020.

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Actual Going Concern Disclosure – Cineworld (international movie chain) (March 2020 annual report) cont.

This analysis does not take account of the fact that in the case of widespread site closures the films scheduled to be released during this period of closure could be moved to later in 2020. These downside scenarios are currently considered unlikely, however it is difficult to predict the overall outcome and impact of COVID-19 at this stage. Under the specific downside scenario, however, of the Group losing the equivalent of between two and three months' total revenue across the entire estate there is a risk of breaching the Group's financial covenants, unless a waiver agreement is reached with the required majority of lenders within the going concern period.

Only the specific downside scenario detailed above would indicate the existence of a material uncertainty which may cast significant doubt about the Group's ability to continue as a going concern. The Consolidated Financial Statements do not include the adjustments that would result if the Group was unable to continue as a going concern.

Leases

A lessor and lessee may decide to modify the terms of a lease agreement as the result of the consequences of COVID-19. In this situation, entities should consider the guidance in FASB ASC 840, *Leases*, specifically 840-10-35-4, which requires lessees and lessors to analyze lease modifications (other than lease renewals or extensions) to determine whether substitution of the modified provisions for the original lease provisions at the inception of the lease would have resulted in a different lease classification at the inception of the lease. In cases where the new lease standard (FASB ASC 842, *Leases*) has been adopted, when a lease modification occurs the lessee has to determine whether the lease modification will be accounted for as a separate contract or as a change to the existing contract. See the guidance in paragraphs 8- 18 of FASB ASC 842-10-25.

Variable Consideration Under FASB ASC 606, *Revenue from Contracts with Customers*

Under FASB ASC 606 (i.e., the new revenue standard), variable consideration should be estimated and recognized throughout the life of the contract subject to an overall constraint. The overall constraint requires that estimates of variable consideration only should be included in the amount considered for revenue recognition to the extent it is probable that a significant reversal in the amounts of cumulative revenue recognized will not occur when the uncertainty is resolved. At the end of each reporting period, an entity should update the estimated transaction price (including updating its assessment of whether an estimate of variable consideration is constrained) to represent faithfully the circumstances present at the end of the reporting period and the changes in circumstances during the reporting period. Entities may need to factor in the consequences of COVID-19 into their update of variable consideration based on conditions at the reporting date.

Risks and Uncertainties Disclosures

FASB ASC 275, *Risks and Uncertainties*, requires disclosures that focus primarily on risks and uncertainties that could significantly affect the amounts reported in the financial statements in the near term or the near-term functioning of the reporting entity. The risks and uncertainties addressed can stem from the nature of an entity's operations, the use of significant estimates, and current vulnerabilities due to certain concentrations. The effects of COVID-19 may negatively impact significant estimates and exacerbate a vulnerability due to certain concentrations (e.g., business concentration in a market severely affected by the effects of COVID-19).

Hedging Relationships

The consequences of COVID-19 may affect the probability of a hedged forecasted transaction and the amounts involved. In those cases, the guidance in FASB ASC 815, *Derivatives and Hedging*, should be applied to determine the continued appropriateness of hedge accounting.

Financial Statements Prepared Under a Special Purpose Framework (SPF)

The guidance and disclosures discussed above in this report apply to U.S. GAAP financial statements. Practitioners are reminded that financial statements prepared in accordance with a SPF (e.g., tax-basis, cash-basis) should include informative disclosures similar to those required by U.S. GAAP when the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with U.S. GAAP. Disclosures in SPF financial statements may substitute qualitative information for some of the quantitative information required by U.S. GAAP or may provide information that communicates the substance of those requirements.

Auditor and Accountant Reporting – Emphasis of Matter

An auditor may conclude that an event has such a material impact on the entity that it would be appropriate to include an emphasis of matter (EOM) paragraph in the auditor's report directing the reader's attention to the event and its effects. As paragraph .06 of AU-C section 706A, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, notes, emphasis-of-matter paragraphs are included in the auditor's report if the auditor considers it necessary to draw users' attention to a matter appropriately presented or disclosed in the financial statements that, in the auditor's professional judgment, is of such importance that it is fundamental to users' understanding of the financial statements. Paragraph A2 of AU-C 706A indicates that a major catastrophe that has had, or continues to have, a significant effect on the entity's financial position is an example of circumstances when the auditor may consider it necessary to include an EOM paragraph.

AR-C 90. 89 and AR-C 90.A142 provides similar guidance related to emphasizing a matter in a review engagement. For compilation engagements, AR-C 80 does not preclude an accountant from including an EOM paragraph in the accountant's compilation report.

Conclusion

The discussion of accounting and reporting issues above is not intended to be all inclusive; rather, the report is intended to be indicative of the types of issues that may need to be addressed in preparing financial statements and considering the consequences of COVID-19 on financial reporting. Other financial reporting issues also may be encountered. As always, the CPEA technical inquiry service is available to answer your inquiries on this topic as well as most other accounting and assurance topics. The inquiry service can be accessed on our website.

Stay Safe

If your office currently remains open we also wanted to provide a link to the Center for Disease Control (CDC) guidelines for cleaning in a workplace and home. Please stay safe during this unprecedented time.

CDC Guidelines for Workplace Cleaning

CDC Guidelines for Home Cleaning

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