COVID-19: Financial Reporting and Disclosures

Understanding the impact of COVID-19 on financial reporting

for entities reporting under ASPE, ASNPO, PSAS and Accounting Standards for Pension Plans

Introduction

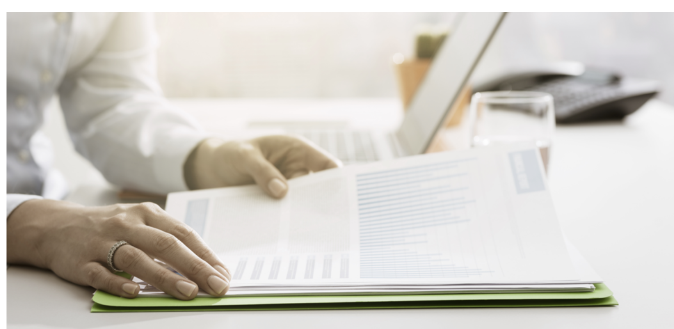
COVID-19 has impacted businesses, not-for-profit organizations, pension funds, public sector entities and financial markets. As countries work to contain the spread of the virus, the extent of its impact continues to evolve. A key consideration for Canadian entities will be the accounting implications and the potential impact the pandemic will have on their financial statements.

This article identifies specific points in key financial reporting areas that should be considered when determining the impact COVID-19 has had on an entity's operations, financial position and disclosures in financial statements. These matters are critical for organizations that report under Accounting Standards for Private Enterprises (ASPE), Accounting Standards for Not-for-Profit Organizations (ASNPO), Accounting Standards for Pensions (ASPP) or Public Sector Accounting Standards (PSAS).

The information presented here is not exhaustive. There may be other areas outside of this report that entities should consider.

How could an entity's financial statements be impacted by COVID-19?

Even if the entity does not see a direct impact from the outbreak, there will be an indirect impact for practically all entities. While some entities may not be severely impacted, and some entities may even benefit, very few will remain unaffected. Therefore each entity will need to consider the financial impact and the areas of the financial statements that will be affected.



Impairment

An entity is required to test its assets for impairment when indicators of impairment are present. Although some indicators of impairment are based on internal information (e.g., damage to property, plant or equipment / tangible capital assets, plans to remove the asset from use), others are triggered by events and circumstances external to the entity. Below are some examples of indicators of impairment that may exist as a result of the economic conditions caused by the spread of COVID-19:

Inventory	• goods are damaged or spoiled (e.g., when the entity ceases or limits operations, due to a decrease in demand) • selling prices decline
Financial assets (e.g., accounts and loans receivable, portfolio investments in other entities)	• There will be a change in the expected timing or amount of payments received in the future
Investments other than portfolio investments (e.g., investment in a subsidiary accounted for using the equity or cost method)	• significant financial difficulty of the investee • a breach of contract (e.g. default or delinquency in debt payments) • it is probable that the investee will enter bankruptcy or other financial reorganization • a significant adverse change in the economic or legal environment in which the investee operates (e.g. recession) • the disappearance of an active market for the investment because of financial difficulties of the investee
Property, plant and equipment / tangible capital assets and intangible assets (other than goodwill)	• significant changes in the extent or manner in which the asset is used or is expected to be used (e.g., idling of a machine such that its future productive capacity may be affected, a machine being used in a manner different from its intended purpose—such as to produce items to support the battle against COVID-19—which may reduce its future productive capacity) • significant changes in the legal factors or business climate that could affect the value of the asset (e.g. the entity expects a decrease in its exports to a particular foreign market as a result of lengthy border closings) • a decline in, or cessation of, the need for the services provided by the asset
Goodwill (applicable to ASPE, ASNPO, ASPP only)	• a significant adverse change in legal factors or in the business climate (e.g. the entity expects a decrease in its exports to a particular foreign market as a result of lengthy border closings) • a loss of key personnel that is other than temporary (e.g., death) • the testing for write-down or impairment of a significant asset group • the recognition of a goodwill impairment loss in an investee's separate financial statements

> Doubt about the entity's ability to continue as a going concern is also a general indicator of impairment for all assets

Government assistance

An entity that has historically not been eligible for government assistance may be entitled to receive it as a result of the COVID-19 pandemic. For all frameworks other than PSAS, entities should first determine whether the accounting for the assistance falls under the accounting framework's guidance for income taxes or governance assistance (ASPE) / contributions (ASNPO). This distinction is important because the accounting may differ significantly. Entities will need to create an inventory of each type of government assistance for which they are eligible and understand fully the terms of such government assistance, including eligibility, timing of assistance and potential repayment, among other factors. Based on the terms of the specific government assistance program, entities must then determine the appropriate period in which to recognize the assistance and, in some cases, establish an appropriate accounting policy to account for the assistance. Publications, short videos, and useful links on what government assistance is available, along with other COVID-19 information can be found on our website here.

New employee benefits and termination benefits

In response to the COVID-19 pandemic, some entities are providing additional benefits to their employees such as:

- paying them during a temporary shutdown of their operations, or while they are sick or in mandatory quarantine; and/or
- providing other compensation to assist employees with working remotely.

If an entity decides to provide new benefits to its employees (i.e., those that were not previously offered), it must determine how to account for the benefits. The financial support or benefits offered to employees will likely meet the definition of a liability; therefore, an entity will need to consider when to recognize the liability/expense and how it should be measured.

Furthermore, as a result of difficult economic conditions, some entities have or will downsize their workforce. If the entity offers or is required to pay termination benefits to the affected employee(s), management must consider how and when to account for the liability/expense in accordance with their relevant accounting framework.

Measuring defined benefit obligations

Measuring a defined benefit obligation such as a pension, post-employment benefits plan or vesting sick leave plan involves making estimates and the use of assumptions (e.g., the appropriate interest rate, future salary increases and employee turnover). Given the sudden fall in markets and the decline in high quality corporate bond rates that have occurred as a result of COVID-19, an entity should consider the impact on its defined benefit obligation(s).

Most entities obtain full actuarial valuations approximately once every three years or as required by their regulator. In between, their actuary rolls forward the figures for financial reporting purposes, although an up-to-date valuation of plan assets is normally required at each reporting date. Management, together with their actuaries, must consider whether the estimate needs to be adjusted, or a more comprehensive valuation obtained, as a result of the impact of COVID-19. For March 31, 2020 and on year ends, it is more likely that revisions to estimates or more comprehensive valuations will be required. Under ASPE only, a significant change in the interest rate used in determining the discount rate to measure the defined benefit obligation does not trigger a requirement for a new actuarial valuation.

Entities should have discussions with their actuaries to ascertain whether COVID-19 has impacted any assumptions in their reports such that their estimates may need to be revisited. The guidance related to subsequent events on whether there may be an adjusting or non-adjusting event should also be considered.

Other areas

Revenue

An entity's revenue may decline as a result of the spread of the virus and the economic impact.

An entity that accounts for its sales contracts using the percentage of completion method may need to revise or refine its calculation related to the degree of completion for one or more of its contracts. For example, it may find that its estimate of total costs or expected efforts will change as a result of COVID-19 and its impact on the global economy. If there are changes in these estimates, there could be a direct impact on the amount of revenue recorded in a fiscal period.

Certain revenue contracts may also become less profitable, or even loss-making. For example, an entity might face penalties as a result of delays or incur increased costs that cannot be recovered due to replacing employees or finding alternative suppliers. Management needs to consider whether any contracts are in an 'onerous' position and whether a liability and loss needs to be recognized.

Also, as a result of COVID-19, an entity might:

- run a promotion in order to help maintain cash flows during temporary closure (e.g., some service-based businesses, like gyms, are offering customers a discount if they prepay for future services)
- offer refunds or credits to its customers for goods or services that cannot be used during this period of crisis (e.g., hotels or event venues, travel agencies, gyms), and/or
- increase the sales of gift cards that can be used at a later date when the crisis is over.

An entity should review its revenue accounting policies to ensure they are still appropriate given the current circumstances.

Where goods and services have been or are being rendered to customers who are either based in regions impacted by COVID-19 or significantly impacted by it, companies will need to assess whether collection is likely, while evaluating new contracts. In the absence of such likelihood, entities may not be able to recognize revenue until or unless payment is received and becomes non-refundable.

Inventory

Some entities may be experiencing supply chain disruptions. Seasonal inventories and perishable products might be exposed to the risk of loss due to damage, contamination, physical deterioration, obsolescence, changes in price levels or other causes. Companies need to assess whether, on the reporting date, an adjustment is required to the carrying value of their inventory to bring them to their net realizable value in accordance with their relevant accounting framework. Estimating net realizable value in such volatile market conditions may also be a challenge, on account of the uncertainties presented by the pandemic.

If an entity's production level is abnormally low (e.g., due to a temporary shutdown of production), it may need to review its inventory costing to ensure that unallocated fixed overheads are recognized in the statement of operations in the period in which they are incurred (i.e., "excess capacity" should be expensed rather than being added to the cost of inventory).

Debt repayment and classification

Some financial institutions (and other creditors) are providing debtholders with the option to defer principal payments for a period of time or a temporary reduction in interest rates. Management will need to assess whether any changes in terms represent a modification or extinguishment of the debt obligation and revisit the portion of the debt that is considered current versus non-current.

As a result of the difficult economic conditions, an entity that is normally able to comply with its debt covenants may find that it is now in violation. In some instances, creditors may not be willing to waive their right to demand repayment. Unless the entity meets certain conditions, it may need to present the entire amount owing as a current liability.

Derecognition of debt or other liabilities

If a creditor forgives an amount owing by an entity, the entity needs to carefully consider the point in time when the liability is discharged and can be derecognized along with the appropriate accounting treatment.

Guarantees

An entity that has guaranteed an amount owing by another entity/individual should consider how the other entity/individual is impacted by the current global situation. Depending on the circumstances, the entity may need to recognize a liability related to the guarantee.

Foreign currency translation

An entity is required to translate foreign currency transactions into the reporting currency using the spot rate in effect on the date of the transaction. As a practical expedient, an entity may translate revenue earned and expenses incurred in a foreign currency using the average rate (e.g., a monthly or annual average). In years when exchange rates remain fairly stable, the difference between using the spot rate vs the average rate will be insignificant. However, some exchange rates are fluctuating significantly during this period of economic uncertainty. As a result, an entity may need to revisit the way it translates foreign currency transactions in its statement of operations and assess whether its current accounting is appropriate.

Insurance claims for business interruption

An entity may have an insurance policy that covers losses from business interruption. If the entity is forced to temporarily cease operations as a result of COVID-19 it may be entitled to recover some or all of its losses from its insurance provider. Such claims would be contingent assets in the financial statements if the entity has a clear right to reimbursement. While contingent gains/assets are generally not recognized in an entity's financial statements, they would be disclosed in the notes to the financial statements when their existence is likely.

Restructuring plans

As a result of the difficult economic environment, an entity may be considering or implementing restructuring plans such as the sale or closure of part of its business or the downsizing of operations (either temporary or permanent). Management should consider whether any long-lived assets need to be classified as held for sale or, in the case of ASPE only, if any portion of its business qualifies for presentation as a discontinued operation.

Financial instrument risk disclosures

Due to the rapidly changing economic environment, an entity may find that it is subject to new or increasing risk (e.g. credit, liquidity, or market risk) or concentrations of risk. In addition, an entity may find that its risks have changed from the prior period. Management should evaluate whether additional risk disclosures are required.

PSAS only requires that an entity disclose a sensitivity analysis (including quantitative disclosures) pertaining to changes in the relevant risk variable that are "reasonably possible" at the reporting date. Management may need to perform sensitivity calculations using a larger range for the risk variables or consider a direction of change that reflects expectations resulting from the COVID-19 pandemic.

Economic dependence (ASPE and ASNPO only)

An entity that is otherwise not economically dependent on another entity or individual may find that circumstances change during this period of crisis. Management should consider whether disclosure regarding economic dependence should be added to the financial statements.

Subsequent events

If the widespread impact of COVID-19 began during the entity's reporting period, the impact will be reflected in its financial statements for that period. However, to the extent that the widespread impact of COVID-19 occurred during the entity's 'subsequent events period' (i.e., the period between the end of the reporting period and the date when the financial statements are authorized for issue), management must determine how the developments subsequent to the year-end should be reflected in the entity's financial statements for the period under audit or review.

Entities are required to distinguish between subsequent events that are adjusting (i.e., those that provide further evidence of conditions that existed at the balance sheet date) and non-adjusting (i.e., those that are indicative of conditions that arose after the balance sheet date). Entities are required to adjust the amounts recognized in their financial statements to reflect any adjusting events that occur during the subsequent events period.

Is the impact of COVID-19 an adjusting event for reporting periods ended December 31, 2019 (or prior)?

In our view, the impact of COVID-19 is generally a non-adjusting subsequent event for reporting periods ended on or before December 31, 2019. Consequently, there would be no impact on the recognition and measurement of assets and liabilities in an entity's financial statements. Although cases of the virus in Wuhan City, China were reported to the World Health Organization (WHO) on December 31, 2019, there was little confirmed evidence of human-to-human transmission at that time and the WHO did not declare the outbreak to be a public health emergency of international concern until January 31, 2020.

As such, it is presumed that the significant development and spread of COVID-19 did not take place until January 2020. Financial statements for an entity with a reporting period ending on or before December 31, 2019 should only reflect the conditions that existed at December 31, 2019 and must therefore exclude the significant effects of the COVID-19 outbreak.

However, entities will need to determine whether they should make additional disclosures to describe the impacts of the outbreak in the subsequent events period. Generally, disclosure should be made of those events during the subsequent events period that do not relate to conditions that existed at the date of the financial statements but cause significant changes to assets or liabilities in the subsequent period and either will, or may, have a significant effect on the future operations of the entity. For material non-adjusting events, an entity must disclose (a) a description of the nature of the event; and (b) an estimate of the financial effect, or a statement that such an estimate cannot be made. Furthermore, the entity should be taking into account their assessment of going concern and adjust the financial statements as appropriate.

Examples of non-adjusting events that would generally result in disclosure include:

- management's plans to deal with the effects of the COVID-19 outbreak and whether there is material uncertainty over the entity's ability to continue as a going concern
- breaches of covenants, waivers or modifications of contractual terms in lending arrangements
- supply chain disruptions
- the assessment of certain purchase or sale agreements as onerous contracts
- announcing a plan to discontinue an operation
- announcing, or commencing the implementation of, a major restructuring or downsizing (temporarily or permanently)
- declines in the fair value of investments held after the reporting period (e.g., pension plan investments)
- abnormally large changes in asset prices or foreign exchange rates
- significant declines in fundraising revenues or reductions in grant revenues, and
- entering into significant commitments or contingencies, such as issuing significant guarantees to related parties.

What is the impact of COVID-19 on financial statements for reporting periods ending after December 31, 2019?

Since late January 2020, the number of COVID-19 cases and countries affected outside of China has grown rapidly, and on March 11, 2020, the WHO declared COVID-19 to be a global pandemic. During this period, governments and various private sector organizations have taken significant measures to contain the virus, including quarantines and school, store, plant and border closures. Consequences of the outbreak have also contributed to significant volatility in global stock markets since late February 2020.

In our view, for reporting periods subsequent to December 31, 2019 (i.e., reporting periods ending in 2020), more information was available that entities will need to factor into their assumptions and assessments. Accordingly, the later the reporting period is after December 31, 2019, the greater the need to consider whether the impacts of COVID-19 in the subsequent events period should be considered an adjusting event in an entity's financial statements.

For periods ending after December 31, 2019, entities will need to use their judgement to determine the impact of COVID-19. They need to carefully consider the conditions that were present at the reporting date. This may not necessarily result in entities reaching the same conclusion for the same reporting date. Management should consider the specific circumstances that relate to the entity's operations and the relevant events that existed in their jurisdiction at that time. For example, some countries have been put on lockdown and people have been told not to leave their homes and some countries have not. If, for example, the entity is in the hospitality industry, this could have a major impact.

Where this judgement has a significant impact on the amounts in the financial statements, it should be disclosed in accordance with the relevant accounting framework.

When it is determined that COVID-19 was an event that existed and caused an impact to operations at or before the reporting date, events subsequent to the reporting date should be accounted for as adjusting events.

Going Concern

Assessing an entity's ability to continue as a going concern

All of the accounting frameworks contain guidance related to the going concern assumption stating that financial statements are prepared on the assumption the entity will continue as a going concern. At each reporting date, management would assess the entity's ability to continue as a going concern and consider all available information about the future, which is at least, but is not limited to, twelve months from the annual reporting date. Management should consider a wide range of factors, such as: current and expected profitability, debt repayment schedules and potential sources of replacement financing, the ability to continue providing services, and for ASNPO and PSAS (if applicable) only, the ability to discharge its stewardship responsibilities . If management concludes that the entity may be liquidated (either by choice or because it has no realistic alternative but to do so), the going concern assumption would not be appropriate and the financial statements may have to be prepared on another basis, such as a liquidation basis. If there is material uncertainty about the entity's ability to continue as a going concern, the entity should include going concern disclosure in the notes to its financial statements.

Because the assessment regarding an entity's ability to continue as a going concern covers a period no less than twelve months from the annual reporting date, all events that occur during an entity's subsequent events period should be considered when evaluating whether there is significant doubt about the entity's ability to continue as a going concern. In other words, even if events during the subsequent events period are not considered adjusting subsequent events, they should still be incorporated into the going concern assessment. Furthermore, events or conditions that cast significant doubt on an entity's ability to continue as a going concern should be disclosed if there are material uncertainties or if a significant amount of judgment is involved in reaching the conclusion about whether the going concern assumption is appropriate.

Conclusion

It is important to remember that this situation is constantly moving. Assessments need to be kept up to date; for example, those carried out two weeks before the financial statements are due to be signed will likely be out of date two weeks later. So, it is crucial to ensure all judgements made are current and based on the information available at the latest date possible (i.e., the date the financial statements are authorized and approved).

We are here to help

We understand that you want to be agile and responsive as the situation unfolds. Having access to experts, insights and accurate information as quickly as possible is critical—but your resources may be stretched at this time.

We're here to support you as you navigate through the impacts of coronavirus on your business and your investments.

Visit our COVID-19 Hub for timely information and resources and connect with your Grant Thornton advisor to learn more.

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