

A low-angle, black and white photograph of several tall skyscrapers reaching towards the sky. The perspective is from the ground looking up, creating a sense of height and scale. The buildings are modern with many windows and balconies.

Accounting, Reporting and Other Internal Control Considerations Resulting from the Coronavirus Outbreak

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Background

The 2019 Novel Coronavirus infection ('coronavirus') or 'COVID-19' outbreak poses a serious public health threat. It has interrupted the movement of people and goods throughout the world, and many levels of government are instituting restrictions on individuals and businesses. The resulting impact on financial reporting will be significant.

Significant development and spread of the coronavirus did not take place until January 2020. At December 31, 2019, only certain events and associated actions had taken place, such as the Wuhan Municipal Health Committee's issue on December 30, 2019.

Although cases were reported to the World Health Organization (WHO) on December 31, 2019, the WHO did not announce the coronavirus as a global health emergency until January 30, 2020, which prompted national governments to begin putting actions in place to slow the spread of COVID-19. In addition, significant measures taken by the Chinese government and by private sector organizations did not take place until early 2020. Subsequent market disruptions in February 2020 confirmed the significance of the January developments.

The spread of COVID-19 after 31 December 2019 may not provide additional evidence about conditions that existed at the balance sheet date of December 31, 2019. However, judgment may be required to evaluate certain events that occurred after a December 31, 2019 balance sheet date to appropriately distinguish between the COVID-19 pandemic and other conditions that may have existed at the balance sheet date.

For reporting periods ended on or ending after January 31, 2020 (including periods ending March 31, 2020), the effects of the coronavirus need to be incorporated into the preparation of financial statements.

SEC Registrant Disclosure Considerations

In February 2020, the SEC and the PCAOB issued a joint statement that included discussion about the effects of COVID-19 on financial reporting. The statement acknowledged this is a dynamic situation and the effects on an individual entity may be difficult to predict. Entities were urged to ensure their financial reporting is robust in light of current circumstances. The joint statement specifically emphasized the need to consider subsequent events disclosures in the footnotes to the financial statements. See [below](#) for a discussion regarding subsequent events disclosures.

In addition to the guidance in this joint statement, entities should consider whether their upcoming filings (i.e., annual reports on Form 10-K and quarterly reports on Form 10-Q) should address potential impacts of COVID-19. At the 2019 AICPA Conference on Current SEC and PCAOB Developments, representatives from the SEC emphasized that if entities expect the impact of evolving risks to be material, they should consider disclosing how management assesses and manages risk, as well as the Board's role in oversight of risk.

Entities need to continue to review and revise their disclosures as risks evolve. COVID-19 has the potential to impact several areas of an entity's filing, including:

➤ *Business*

This section focuses on a description of an entity's business and how it operates. It may also include discussion of recent events, competition, regulation, and seasonality. COVID-19 may have caused an entity to change the way a business operates, may have caused temporary closures, and could even result in an entity deciding to liquidate assets or a business. If an entity has changed how the business operates, or if the entity plans to make changes in response to the conditions created by COVID-19, the disclosures should address such changes.

➤ *Risk Factors*

This section should include information about the most significant risks an entity faces. Some of these risks may relate to the overall economy, some to the industry or geographic area in which an entity operates, and some may be unique to the entity itself. Entities may have already included general risk factors that address natural disasters or geopolitical matters; however, COVID-19 may present more specific risks that entities should consider explicitly disclosing.

➤ *Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A)*

This section typically focuses on the entity's perspective on the business results, where the entity tells its own story. Known trends and uncertainties that have had, or are expected to have, an unfavorable effect on revenues or income should be discussed. The impacts of COVID-19 may present known trends for certain types of organizations, such as those in consumer-facing industries (e.g., travel, hospitality, retail, etc.), and will likely present a myriad of uncertainties for other organizations. Entities 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 COVID-19 should include robust discussions of these circumstances. Entities should also consider whether the impacts of COVID-19 necessitate early warning disclosures regarding potential impairments or other charges, as well as impacts to revenues, gross profit margins, net income, and financial arrangements that might be expected.

➤ *Quantitative and Qualitative Disclosures about Market Risks*

This section should focus on an entity's exposure to market risks, such as interest rate risk, credit risk, foreign currency risk, and commodity price risk, and how the entity manages these risks. COVID-19 has caused significant market disruptions, temporary business closures, and significant market volatility. Entities should consider disclosing how these issues are affecting the entity, and how they are managing these risks.

COVID-19 has impacted many organizations in a variety of ways, such as supply chain disruptions, temporary closures, loss of revenue from customers, work stoppages, production or construction delays, losses of contracts, defaults by customers, etc. Entities should consult with their legal counsel about the appropriate disclosures given their specific facts and circumstances.

Filing Relief for Registrants Impacted by the Coronavirus and Disclosure Guidance

The SEC provided conditional relief for registrants that are impacted by COVID-19 and are unable to file on a timely basis (the “order”). On March 25, 2020, the SEC issued a [new order](#) extending the due date by 45 days to file certain SEC disclosure reports, such as Forms 10-K or 10-Q. The exemptions granted related to reporting and proxy delivery requirements for registrants and the new order had modified exemptions to now cover filings due between March 1, 2020 and July 1, 2020. Registrants must disclose why they were unable to file on a timely basis.

Additional steps must be taken to take advantage of the extension, including a requirement to furnish a Form 8-K by the original reporting deadline, which includes the following information:

1. A statement that the registrant is relying on the SECs exemptive order that provided the relief;
2. A brief description of the reasons why the registrant cannot file on a timely basis;
3. The estimated date the registrant expects to file;
4. If appropriate, a risk factor explaining the impact of the coronavirus on the registrant’s business (if material); and
5. If the reason the registrant is unable to file relates to a person other than the registrant, the Form 8-K must include an exhibit signed by that person containing the specific reasons why that person is unable to provide its opinion, report, certification, etc.

Entities are still permitted to rely on the grace period in Exchange Act Rule 12b-25 to receive additional time to file the report (fifteen calendar days for an annual report and five calendar days for a quarterly report). Companies that take advantage of the extension or the grace period permitted by Rule 12b-25 will still be considered current and timely Exchange Act filers for purposes of Form S-3 and Form S-8 eligibility.

The SEC Division of Corporation Finance (Corp Fin) also issued [Disclosure Guidance Topic No. 9](#) which provides the SEC staff’s views on disclosures and securities law obligations that registrants should consider related to COVID-19, including business and market disruptions. The SEC Corp Fin staff recognizes that information related to COVID-19 is continuously evolving and that registrants may be unable to currently predict the impact on their business, financial condition, and results of operations. However, the SEC Corp Fin staff expect registrants to disclose:

- The impacts COVID-19 has had on the registrant’s business;
- Management’s expectations of its future impact and management’s response; and
- Management’s plans for addressing related uncertainties.

Disclosures should be specific to the registrant and are those that have a material impact. Consideration should be given to whether such disclosures involve forward-looking information to ensure that the information is provided in a manner that maintains the safe harbors under the Securities Act and the Exchange Act.

The staff of Corp Fin also reminded registrants to consider the requirements of trading activities by the officers and directors and other insiders of the registrant who have access to material non-public information that impacts the registrant, before that information is disclosed publicly. Registrants were

also reminded of S-K Regulation G and Item 10 requirements on non-GAAP measures and to proactively address financial reporting matters.

For additional information, refer to the SEC's [exemptive order](#).

Financial Statement Disclosures

DISCLOSURE OF LOSS CONTINGENCIES

ASC 450, CONTINGENCIES

When there is at least a reasonable possibility that a loss has been incurred, disclosure of the nature of the contingency is required, as well as an estimate of the possible loss or the range of possible losses (or a statement that such an estimate cannot be made). When a loss occurs (or may have occurred) after the balance sheet date, but before the financial statements are issued, it should be evaluated as a subsequent event. See the [Subsequent Events](#) discussion later in this document for additional considerations.

CASH FLOW STATEMENT PRESENTATION OF INSURANCE PROCEEDS

ASC 230, STATEMENT OF CASH FLOWS

Insurance proceeds, such as business interruption insurance, are classified based on the nature of the insurance coverage rather than the intended use of the proceeds. Accordingly, amounts received for business interruption are presented as operating activities.

In addition, when cash proceeds from insurance are significant, SEC registrants should disclose where the proceeds are classified in the statement of cash flows and discuss the insurance proceeds or settlements in MD&A. The discussion should include a description of the proceeds or settlement, why it was received, planned use for the receipts, and any impact to reported earnings.

RISKS AND UNCERTAINTIES DISCLOSURES

ASC 275, RISKS AND UNCERTAINTIES

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 should be disclosed. Risks and uncertainties can stem from the nature of an entity's operations, the use of estimates in the preparation of the financial statements, or significant concentrations in an entity's operations.

Many entities' operations have been affected by COVID-19, though the extent varies. If information comes to light prior to the issuance of the financial statements (or the financial statements being available to be issued) that it is at least reasonably possible that significant estimates will change in the near future and the change would be material, entities should add incremental disclosure.

As described below in the [Accounting Considerations](#) section, there are many financial statement areas that could potentially be affected by COVID-19 – most of which involve impairment or valuation analyses.

Supply chain disruptions, temporary work stoppages, business closures, and reduced sales volumes are all examples of potential impacts from COVID-19 that may impact significant estimates and would warrant incremental disclosure.

Entities may have concentrations that present greater risk to the financial condition or results of operations, such as customers, suppliers, geographic locations, products, etc. When an entity is aware that a concentration exists that makes it 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 cause a severe impact in the near term, incremental disclosure is required. If an entity has a concentration in an activity or areas affected by COVID-19 (i.e., travel-related business facing temporary closure, supply chain disruption from a major supplier, significant change in customer buying behaviors or cancelling of orders, etc.), disclosure of the potential near-term impact should be disclosed.

These disclosures are essentially “early-warning” disclosures designed to draw attention to areas of risk or known trends or uncertainties. These disclosures are similar to the SEC’s requirements to discuss known trends or uncertainties within MD&A, as well as to provide “early-warning” disclosures in the disclosures of critical accounting estimates.

GOING CONCERN

ASC 205-40, PRESENTATION OF FINANCIAL STATEMENTS – GOING CONCERN

Management is required to evaluate 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). If management concludes there is substantial doubt, then disclosure in the financial statements is required, even if management’s plans alleviate that substantial doubt.

Due to the outbreak of COVID-19, entities may face extended closures, reduced access to customers, supply chain disruptions, difficulty collecting from customers and other counterparties, or other events that negatively affect operating cash flows and liquidity. The current uncertainty continues to evolve and will make it difficult for entities to evaluate the impact on an entity’s ability to obtain, extend, or renew credit agreements, or they may experience loan covenant violations. There is also uncertainty about access to other sources of capital. These types of events will need to be considered in an entity’s going concern analysis.

SUBSEQUENT EVENTS

ASC 855-10, SUBSEQUENT EVENTS

Prior to the issuance of the financial statements, all available information should be considered to evaluate whether it provides additional evidence about conditions that existed as of the balance sheet date, such as estimates. In these circumstances, this information may stem from conditions that have existed for some time but are just now emerging. If significant, the financial statements should be adjusted for this type of information. However, caution must be exercised to ensure that financial statements are not adjusted for events and conditions that did not exist as of the balance sheet date. If the additional information reflects new events or conditions, disclosure in the financial statements about the nature of

the events and the potential impacts on the financial statements is appropriate to prevent the financial statements from being misleading.

COVID-19 IMPACT TO DISCLOSURES

Disruption of operations, volatility, and uncertainty caused by the COVID-19 outbreak will result in most entities disclosing information about the negative impact to operations, potential impairments, future losses, and general uncertainty confronting their businesses. U.S. GAAP requires entities to disclose significant risks and uncertainties, as well as subsequent events.

The analysis below provides a discussion of when disclosures of an uncertainty may be necessary due to the impacts of changes in the business environment arising from COVID-19. For example, if pending changes to forecasts will likely impact the GAAP assessments around going concern or recoverability of assets, the impact of those changes should be disclosed.

The framework below deals with disclosures of uncertainties and possible impacts on an entity's disclosures.

Framework for consideration of entity disclosures around COVID-19

When an entity has known material curtailments at the balance sheet date, or prior to issuance of its financial statements, then the entity would likely need to disclose those matters in order to fairly present the financial statements so that investors have the material information. Such known curtailments may include, but are not limited to, one or more of the following:

- The entity's customers may have reduced their demand for the product or service or may have cancelled non-enforceable contracts.
- The entity's suppliers may have reduced their production or other ability to supply the entity with goods or services causing the entity to be unable to continue its revenue generating activities.
- The entity may not be able to perform ordinary reporting, administrative, and other functions due to constraints on how its workforce can perform their functions.
- Cash flows may be materially altered in the period since year-end, as a consequence of changes in travel, increased shut down of business locations, and intensified government actions in the U.S.
- While the entity may be able to continue its business, the customers or supply chains it depends on are or likely may no longer (be) as available as they were previously (for example, a third party seller that depended on Amazon as a market channel, or a provider of storage services where its existing and potential customers may no longer be able to continue or take up new services).
- Liabilities may be subject to debt covenants that no longer can be met due to other changes in cash flows, or to the entity being unable to provide financial information as required by the debt agreement.
- The potential impact of government actions, such as the Defense Production Act of 1950 (the so-called "War Powers Act"), which grants the federal government the power to direct the activities of

a U.S. based business, on the entity. These impacts may be on the entity's service or manufacturing capabilities and also may affect its customers or suppliers.

- The potential impact on entities that, through their trade groups or other collective bodies, have asked for government assistance, or of any conditions attached to assistance.

These circumstances may bring immediate impacts to entities that are already visible (e.g., employee layoffs or reduction in business activity). These circumstances may also bring material uncertainties to other entities where the nature and the extent of the impact may be significant, but there is a material uncertainty as to the likelihood, timing, and/or extent of that impact.

In all these cases, the users of financial statements should be informed by virtue of disclosure by the entity of the known impacts, the expected impacts, and the possible impacts of uncertainties on the business in order for those users to make informed decisions about the information reported in the financial statements.

While each entity's circumstances may differ, the users need to be informed of the uncertainties. Where an entity concludes there is likely no impact, it would be advisable to provide that disclosure, so users understand management's assessment.

Accounting Considerations

COVID-19 has already had significant impacts to business activities around the globe and has caused severe market disruptions. This is an evolving situation that entities need to continually assess and analyze. There are many accounting areas that entities will need to evaluate to determine whether adjustments to the financial statements are required, or whether additional disclosures are necessary. This is particularly true with impairment assessments and valuations. The accounting guidance for impairments differ by the type of potential loss. The following discussion highlights some of the key financial statement areas that may be impacted by COVID-19.

LOANS AND RECEIVABLES

ASC 326, CREDIT LOSSES, ASC 310, RECEIVABLES, ASC 450, CONTINGENCIES – LOSS CONTINGENCIES

ASC 310-40, RECEIVABLES – TROUBLED DEBT RESTRUCTURINGS BY CREDITORS

Loans and receivables to entities impacted by COVID-19 may be at risk of non-performance. Additionally, a customer or borrower may be experiencing financial difficulty, and an entity may work with its customer to attempt to collect amounts due by restructuring the arrangement or offering concessions to the customer to mitigate expected losses.

Loans and receivables are measured for collectability through recognition of an allowance for doubtful accounts or an allowance for credit losses. For entities that have adopted ASC Topic 326, *Credit Losses*, expected losses should be recognized based on historical experience, current conditions, and reasonable

and supportable forecasts. The impacts of COVID-19 may necessitate adjustments to these estimates, particularly the forecasts of expected losses.

Entities that have not yet adopted ASC Topic 326 are subject to ASC 310 and ASC 450-20. These entities recognize impairment of receivables and loans when losses are incurred, which is when it is probable that an entity will be unable to collect all amounts due according to the contractual terms of the arrangement. Impairment is measured based on the present value of expected future cash flows discounted at the receivable's or loan's effective interest rate, except that, as a practical expedient, impairment can be measured based on a receivable's or loan's observable market price or the fair value of the underlying collateral.

When a borrower is experiencing financial difficulty and the creditor grants a concession to the borrower, the restructuring should be accounted for, and disclosed as, a troubled debt restructuring (TDR). Such situations may arise, as customers may be experiencing temporary disruptions in cash flows from the impacts of COVID-19 that hinder their ability to make payments in accordance with the original terms of the receivable or loan. Entities will need to consider whether activities undertaken with borrowers to work through cash flow disruptions constitute a TDR, measure any TDR impairment, and provide the necessary disclosures for restructuring activities.

INVENTORY

ASC 330, *INVENTORY*

The effects of the outbreak may result in declines in sales or significant disruptions to supply chains. This is particularly true for perishable goods or seasonal inventories. Companies should evaluate their inventories for damage, spoilage, or obsolescence caused by the effects of the outbreak.

Inventory measured using any method other than LIFO or the retail inventory method (for example, inventory measured using first-in, first-out (FIFO) or average cost) shall be measured at the lower of cost and net realizable value. When evidence exists that the net realizable value of inventory is lower than its cost, the difference shall be recognized as a loss in earnings in the period in which it occurs.

Inventory measured using the LIFO or the retail method should be adjusted to the lower of cost and market through current period earnings in the period when the utility of the goods is no longer as great as their cost.

Additionally, if production is decreased, entities must consider that fixed overhead is allocated based on 'normal capacity'. If an entity ceases production or significantly reduces production for a period of time, significant portions of fixed production overhead (e.g., rent, depreciation of assets, some fixed labor, etc.) will need to be expensed rather than capitalized, even if some reduced quantity of inventory continues to be produced.

INVESTMENTS

ASC 320, INVESTMENTS

With the recent market volatility stemming from the impacts of COVID-19, entities should evaluate the impacts of these severe market disruptions on the fair value of their investments when considering if those investments are impaired. Investments in debt securities may be negatively impacted by widening credit spreads, issuers of the debt securities may no longer be able to repay amounts owed, and market trading prices may be negatively affected.

Investments in equity securities may have experienced significant declines in fair value, and equity method investments may have experienced challenges that indicate the investment may not be recoverable. There are several impairment models applicable to investments depending on the type of investment (i.e., debt securities vs. equity securities), an entity's classification of its investments (i.e., held-to-maturity or available-for-sale), facts and circumstances unique to the specific investment (i.e., equity securities without readily determinable fair values), as well as the effective date for the adoption of ASC 326, *Credit Losses*.

INDEFINITE-LIVED INTANGIBLE ASSETS

ASC 350-30, INTANGIBLES – GOODWILL AND OTHER – GENERAL INTANGIBLES OTHER THAN GOODWILL

Indefinite-lived intangible assets are tested for impairment annually, or more frequently if events or circumstances indicate the asset might be impaired, by comparing the fair value of the assets to their carrying amounts (referred to as triggering events). To assess whether a triggering event has occurred, entities must consider events or circumstances such as macroeconomic conditions, industry and market conditions, cost factors that have a negative effect on earnings and cash flows, and overall financial performance. Because the COVID-19 situation continues to evolve, it is possible that triggering events could occur throughout the year, necessitating more frequent impairment assessments. This impairment assessment will need to be completed prior to the issuance of quarterly financial statements.

An entity may first perform a qualitative assessment to determine whether it is necessary to perform the quantitative assessment. An indefinite-lived intangible asset is initially tested for impairment before a larger asset group that includes the intangible asset is assessed for recoverability. The quantitative assessment involves comparing the fair value to the carrying value. If the fair value is less than the carrying value, an impairment is recognized.

Indefinite-lived intangible assets are tested for impairment prior to long-lived assets and goodwill.

LONG-LIVED ASSETS

ASC 360-10, PROPERTY, PLANT AND EQUIPMENT

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*, are tested for recoverability at the asset group level whenever events or circumstances indicate that the carrying amount of the asset group may not be recoverable. The impacts of COVID-19 may be such an event or circumstance. For example, commercial

real estate held for use may be dependent on rent from tenants to operate. These tenants may have experienced extended closures, and thus significant reductions in cash flows and ability to pay rents. This could in turn trigger impairment of the asset. If the asset group is not recoverable, its carrying amount is reduced to its fair value. In this context, we note certain real estate sectors may require special consideration due to recent declines in consumer activity (e.g., the hotel and retail markets).

If an entity concludes that it will sell long-lived assets and the “held for sale” criteria are met, a loss should be recognized, if applicable, for a write-down of the disposal group to fair value. Entities will also need to consider whether long-lived assets that are held-for-sale continue to meet the criteria for this classification given current conditions.

Groups of long-lived assets are tested for impairment after indefinite-lived intangible assets, and before goodwill.

GOODWILL

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 would more likely than not reduce the fair value of the reporting unit below its carrying amount (referred to as triggering events). To assess whether a triggering event has occurred, entities must consider macroeconomic conditions, industry and market conditions, cost factors that have a negative effect on earnings and cash flows, overall financial performance, events affecting the reporting unit, and sustained decreases in share price. COVID-19 has caused severe market disruptions, temporary business closures, supply chain disruption, increased risk of counterparties and customers not performing on their obligations, and volatile markets that have seen rapid declines unlike anything ever experienced in the United States. As a result, a triggering event may have occurred for many entities, particularly if a sustained stock price decrease has occurred over a reasonable period of time leading up to the date of the potential impairment.

Entities first qualitatively assess whether it is more likely than not that the fair value of the reporting unit is less than the carrying amount and, if so, a quantitative impairment analysis must be performed. The quantitative test involves comparing the fair value of the reporting unit to the carrying value. The effects of COVID-19 on market conditions may have direct or indirect effects of estimates of future cash flows and earnings that need to be considered in an impairment assessment. Additionally, once a triggering event has occurred, the goodwill impairment analysis should be completed before the financial statements are issued, including quarterly financial statements. As conditions continue to evolve due to global market and government reactions to COVID-19, triggering events may continue to occur throughout the year, which may result in more frequent assessments of impairment.

Goodwill is tested for impairment only after indefinite-lived intangible assets and other long-term amortizing assets, such as property and equipment and right-of-use assets, have been assessed.

TEMPORARY DIFFERENCES AND DEFERRED TAX ASSET VALUATION ALLOWANCES

ASC 740, *INCOME TAXES*

Book recognition of reserves, accruals, and impairments would likely impact the recognition and measurement of temporary differences and related tax accounting. Accordingly, careful consideration should be given to the following with respect to the accounting for income taxes in the period that book losses, reserves, and impairments are recognized:

- For entities with tax basis in goodwill, large deferred tax assets could potentially originate as a result of book goodwill impairments; as such, the future realization of such deferred tax assets should be assessed taking into consideration all available positive and negative evidence as of the reporting date.
- Entities that have historically depended upon reversing taxable temporary difference related to book intangibles with no tax basis as a source of income to realize existing deferred tax assets may find this source depleted as a result of impairments to the underlying book intangibles. In the entity's consideration of other sources of income, specifically future taxable income, the effects of COVID-19 on obtaining projected results should be considered.
- With respect to book impairments of nondeductible goodwill for tax purposes for which no deferred tax effect is recorded, consideration should be given to the treatment of the related impairment as a reconciling item in the computation of the annual effective tax rate or as a discrete item.
- For income tax purposes, uncollectible receivables can be deducted when they are considered "worthless." The worthlessness of a debt is a question of fact. Obsolete inventory can be deducted when it is no longer able to be used or sold in a "normal" manner and it is being disposed of through a liquidator or junkyard, a donation, or it is destroyed. Consideration should be given to any timing differences between book and tax treatment in addition to any uncertain tax positions that may arise.
- Entities that have historically asserted indefinite reinvestment in foreign operations should revisit this assertion, taking into consideration any contradicting evidence related to the parent or upstream entity's ability to service debt, meet working capital needs, or make required changes to infrastructure considering the economic impact of COVID-19.
- As new tax law emerges to address the economic impact of COVID-19, consideration should be given to the impact of such tax law changes in the period in which they are enacted.

DEBT

ASC 470, *DEBT*, ASC 470-50, *DEBT – MODIFICATIONS AND EXTINGUISHMENTS*, ASC 470-60, *DEBT – TROUBLED DEBT RESTRUCTURINGS BY DEBTORS*

Many entities are facing temporary closures to help contain the spread of COVID-19. This will likely result in disruptions of normal business operations, lost revenue, or reduced collections of customer receivables, all of which may negatively affect cash flow available to service debt. Further, many debt agreements

include various covenants, some of which may be based on total assets, net income, cash flow, or equity – all of which may be negatively impacted in the current environment.

Debt payable within one year is presented as a current liability, while long-term debt generally refers to arrangements due more than one year from the balance sheet date, although certain exceptions exist. ASC 470-10-45 addresses several specific situations, including lock-box arrangements and subjective acceleration clauses.

Generally, a covenant violation occurring after the balance sheet date is considered a non-recognized subsequent event under ASC 855, which does not impact the classification of debt at the balance sheet date. However, that principle is subject to judgment when the “facts and circumstances indicate otherwise,” as noted in ASC 470-10-45-1.

As such, if a covenant violation occurs after the balance sheet date but before the financial statements are issued, current classification would be required unless the entity obtains a waiver before the financial statements are issued, such that the lender is not able to require repayment for more than one year after the balance sheet date. If the issuance of December 31, 2019 financial statements is delayed, these scenarios may become more frequent.

Similarly, if a covenant violation has not occurred prior to issuance, but it is probable the entity will violate a covenant within a year of the balance sheet date, judgment will be required to determine the appropriate classification. Entities are encouraged to consult with their advisers in these situations.

As entities work with lenders to address these potential issues, terms of debt arrangements may be modified to address covenant violations, or payment terms may be changed to alleviate cash flow burdens in the near-term. Entities may wish to conduct these lender negotiations in light of the going concern assessment period, which is typically one year after the financial statements are issued (as opposed to one year after the balance sheet date). Entities will also need to consider whether modifications are troubled debt restructurings. If they are not troubled debt restructurings, further analysis on whether the changes in terms should be accounted for as a modification or as an extinguishment will be required.

DERIVATIVES AND HEDGE ACCOUNTING

ASC 815, *DERIVATIVES AND HEDGING*

Supply chain disruptions, work closures, and potential curtailing of business activity may result in reductions, delays, or even cancellations of business transactions. If these forecasted business transactions were previously designated in cash flow hedge relationships, entities will need to determine whether these transactions are still probable of occurring to continue to apply hedge accounting. Additionally, entities will need to consider changes in counterparty credit risk to assess whether forecasted transactions are still probable of occurring. If the hedged transaction is no longer probable of occurring within the originally specified time period, hedge accounting should be discontinued prospectively. However, the related gains and losses in accumulated other comprehensive income should be reclassified in earnings only if it is probable that the forecasted transaction will not occur by the end of the period originally specified or within an additional two-months.

The impact of COVID-19 also may affect the eligibility for the “normal purchases and normal sales” scope exception to derivatives accounting for commodity contracts (e.g., oil and gas). This exception is based on physical delivery and if that is no longer probable due to curtailment or cancellation of operations such that the contract will now settle net, the eligibility for applying this scope exception would no longer be met. Consequently, the contract should be recorded on the balance sheet at its current fair value with changes in fair value recognized in earnings, like any other derivative.

The current response to COVID-19 may prompt legal questions about whether the market events mentioned above regarding the “normal purchases and normal sales” exception for commodity contracts constitute a force majeure, which is a legal basis for excusing non-performance and a right to terminate a contract. This is a legal question, so entities are encouraged to seek legal counsel in this area.

FAIR VALUE MEASUREMENTS

ASC 820, FAIR VALUE MEASUREMENT

There are many areas of U.S. GAAP that require the use of a fair value measurement. Fair value is defined 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. One of the key concepts in that definition is an orderly transaction, which is designed to differentiate between what is considered a fair value measurement vs. a distressed sale or a forced transaction.

Current market conditions are under extreme stress and may produce values that an entity may wish to disregard; however, it would only be appropriate to disregard market observable values or inputs to a fair value measurement if they were based on transactions that were not ‘orderly’ transactions. In addition, recent events are likely to impact credit risk in fair value measurements. This could affect a counterparty’s ability to pay under receivable and derivative contracts, as well as the entity’s own risk of nonperformance (e.g., if the entity reports its own debt at fair value).

REVENUE RECOGNITION

ASC 606, REVENUE FROM CONTRACTS WITH CUSTOMERS

The consideration to which an entity is entitled from a revenue contract is assessed to determine if collectability is probable before the revenue standard is applied to the arrangement (part of Step 1). “Probable” means that collectability is likely to occur. The assessment is based on a customer’s ability and intent to pay the amount of consideration under the contract, once those amounts become due, based on all relevant facts and circumstances. An entity’s ability to collect the consideration due also considers methods to reduce the credit risk such as amounts that are prepaid or the ability of the entity to stop transferring goods or services to a customer if that customer fails to make payments when due. A reassessment of the criteria to determine if there is a contract, including collectability, is only done when there are indications of significant changes in facts and circumstances, which requires judgment. The current uncertainty may indicate that collectability under a revenue contract is no longer probable and thus the revenue model would not be applied to that contract.

Step 3 of the revenue model is to determine the transaction price. That includes determining whether there is any variable consideration and whether the amount of revenue recognized should be constrained. The effect of the constraint is that the estimated transaction price only includes the amount of variable consideration if it is probable that there will not be a subsequent significant reversal in the amount of revenue recognized at the point at which uncertainty over the amount of variable consideration is resolved. Entities will also need to evaluate whether changes in contract prices represent a modification of the transaction price or reflect impairment of a contract asset or accounts receivable.

Current market conditions may require companies to reevaluate both the collectability of contracts with customers and the amount of revenue that is recognized. When a customer no longer has the ability to pay for goods or services to be transferred, an entity reassesses the criteria in Step 1 of ASC 606 and may determine that the criteria are not met if the entity no longer believes that it will collect the consideration to which it will be entitled and thus would no longer recognize revenue for that contract. Accounts receivable for goods or services already provided for that customer would be evaluated for impairment in accordance with ASC 310, as noted above.

An entity may provide refunds or concessions to a customer that were not previously provided and thus the guidance on accounting for variable consideration will now need to be applied to those contracts. Prior estimates of receiving variable consideration will likely also need to be reevaluated, as circumstances that were previously predicted to occur may no longer be probable. For example, the possibility of refunding previously collected amounts will need to be considered.

These conditions may also necessitate that an entity reassess its estimates of variable consideration each period due to price concessions or other adjustments made to the transaction price to assist customers whose businesses are impacted by COVID-19 and whether the amount of revenue to recognize should change. The assessment of the transaction price, including estimations of variable consideration, is made at the start of a contract and then reassessed at each reporting date based on all reasonably available information. These judgments are required to be disclosed in the notes to the financial statements. Determining the amount of variable consideration that is not constrained is based on the significance of the potential reversal of cumulative revenue recognized, at the contract level, and the likelihood of that occurring. ASC 606 provides a list of factors to consider that increase the likelihood or magnitude of a revenue reversal.

Incremental costs to obtain a contract are recognized as assets when an entity expects to recover those costs. Costs to fulfill a contract (e.g., direct labor or materials, other costs chargeable to a customer) that are not subject to other ASC Topics are capitalized if they relate directly to a contract, generate or enhance resources of the entity used in satisfying a performance obligation, and are expected to be recovered. Costs to obtain or fulfill a contract that are capitalized are amortized over the period that the goods or services are transferred to the customer and are evaluated for impairment under either ASC 340-40 or for fulfillment costs capitalized in accordance with accounting guidance outside of ASC 606, such as ASC 330, *Inventory*, based on that guidance. The current economic environment may lead to additional impairment charges for contract assets where the carrying amount exceeds the amount of consideration the entity expects to receive in the future and that has been received but not recognized as revenue, and the costs that relate directly to providing those goods or services and that have not been recognized as expenses.

LEASES

ASC 842, LEASES

Landlords may be offering concessions to lessees in the form of free rent, deferral of rent payments, or cash payments when operations of the lessee are interrupted or are significantly affected. 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 landlord concession is a modification or a concession in accordance with the original lease will depend on the terms of the lease contract and enforceable rights and obligations of the lessee and lessor. For example, a lease contract may contain force majeure events requiring rent reductions or free rent periods. Landlord concessions that are considered modifications typically will be accounted for as a modification of the original lease (i.e., not as a separate contract) because the modification will not grant the lessee any additional right of use. The modification of an existing lease will require the lessee to remeasure and reallocate the remaining consideration in the contract; reassess lease classification; update the discount rate; and remeasure the lease liability and the carrying amount of the right-of-use asset. A lessor will make a similar determination to account for a lease modification as a modification of the existing lease and make appropriate changes to remeasure amounts recorded. Lease terminations (full or partial) will also need to be accounted for by the lessee and the lessor in accordance with ASC 842.

A key tenet of lessors' accounting for operating leases on a straight-line basis relates to a lessor's assessment that collection of the lease payments plus amounts to satisfy a residual value guarantee is probable. This assessment is performed at the commencement date and through the end of the lease term. If collection is not probable, lease income is limited to the lesser of the income recognized on a straight-line basis and lease payments collected by the lessee. In the current environment, lessors should exercise additional care in performing this collectability assessment.

Lessees should monitor whether there are any indications of right-of-use asset impairment; for example, a retail store that a lessee leases with an expected decrease in future cash flows from sales, or a warehouse leased on a long-term basis for which a lessee's plans may change (such as abandonment). Right-of-use assets are tested by lessees for impairment in accordance with ASC 360-10, noted above. Even if a right-of-use asset is not impaired, a lessee may have to reassess the useful life of the asset as appropriate (for example, when the right-of-use asset is part of a larger asset group that is not impaired, but the entity plans on abandoning the lease before the end of the initial lease term). In the current environment, lessees should exercise care in monitoring and timely identifying triggering events requiring impairment testing.

For lessors, the net investment in leases associated with sales-type and direct financing leases is accounted for within the impairment model under ASC 326, which is discussed above. Lessors will consider, among other things, the lessee's credit risk as it relates to cash flows related to the lease payments, along with cash flows expected from the unguaranteed residual asset following the end of the lease term. Lessors with operating leases will apply ASC 360 to measure any impairment on the long-lived assets. In the current environment, the level of judgment in assessing/determining impairments generally will increase.

A lessee and a lessor consider all relevant contractual provisions of a lease in determining the lease term at the commencement date, including renewal and termination options. Only those options that are

reasonably certain of exercise by the lessee affect the initial measurement of the lease. A lessee then typically reassesses the lease term or a lessee purchase option only when a significant event or a change in circumstances that is within the lessee's control occurs, when the lessee elects an option previously not deemed reasonably certain of exercise (for example, a termination option), or when the lessee elects not to exercise an option it previously deemed reasonably certain of exercise (for example, a renewal option). In the current environment, lessees should exercise care in monitoring and timely identifying all events requiring a remeasurement of the lease.

A lessor does not reassess the lease term unless there is a modification that is not accounted for as a separate contract.

STOCK COMPENSATION

ASC 718, COMPENSATION – STOCK COMPENSATION

Share-based awards typically contain either a service, performance, or market condition for vesting, or some combination of conditions. The accounting for share-based payment awards will depend on the type of vesting conditions. Awards with performance conditions are accounted for when it is probable that the performance condition will be achieved. An entity reassesses the probability of achieving the performance condition at each reporting date. The achievement of certain performance conditions in the current environment may no longer be probable. For awards for which an entity had previously determined that the achievement of the performance condition was probable but now believe that it is not probable, the entity would reverse the compensation cost previously recorded and continue to assess the probability over the service period.

Due to the disruption to a business and the ability of a grantee to meet performance conditions as a result of the COVID-19 pandemic, entities may make modifications to share-based payment arrangements, such as extending vesting periods or changing the terms of vesting conditions, that need to be accounted for. Modification accounting is only applied when the changes to the fair value, vesting conditions, or classification of an award as liability or equity changes as a result of the change in terms. This will cause entities to have to measure the incremental fair value of modified arrangements (equity classified) and to assess the effect of the modification on the number of awards that are expected to vest. This may lead to entities recording additional compensation cost for awards and reconsideration as to whether original service or performance conditions are likely to be met. The accounting for share-based payment arrangements with performance or service conditions will be based on the type of modification. The fair value of a share-based payment award classified as a liability would be remeasured at the date of the modification.

For entities that estimate forfeitures of awards, the estimation is based on the number of awards for which it is probable that the requisite service period will be rendered, and those estimates are updated as new information becomes available. The amount of compensation expense that is recorded each period is at least equal to the grant-date fair value of the vested portion of the awards. Due to the uncertainty of the impact of COVID-19, entities will need to continuously reevaluate their forfeiture estimates for share-based payment awards.

BUSINESS INTERRUPTION INSURANCE RECOVERIES

ASC 225-30, BUSINESS INTERRUPTION INSURANCE

Many organizations have decided to close temporarily to help prevent the spread of COVID-19, which may cause lost revenue and serious disruptions to supply chains, resulting in losses. These losses may be covered by business interruption insurance and should be accounted for separately from other insurance proceeds. When losses incurred can be reasonably estimated and recovery is considered probable, a receivable for the expected insurance proceeds may be recorded. However, the amount recorded should not be greater than costs incurred to date. Therefore, proceeds for lost profits are treated as a contingent gain and typically recorded at the settlement date.

If business interruption insurance is received, entities may elect a policy for how such amounts are presented in the income statement, as long as it does not conflict with other applicable GAAP. The notes to the financial statements should disclose the nature of the event resulting in business interruption losses, the aggregate amount of business interruption insurance recoveries recognized during the period, and the line items in the income statement in which those recoveries are classified.

CONTINGENT LOSSES

ASC 450-20, CONTINGENCIES – LOSS CONTINGENCIES

Certain legal matters or other contingency accruals could arise as a result of the current economic environment or an entity's actions taken in response to COVID-19. Contingent losses should be accrued by a charge to income if it is probable that it has been incurred at the financial statement date and the amount of the loss can be reasonably estimated.

EXIT ACTIVITIES

ASC 420, EXIT OR DISPOSAL COST OBLIGATIONS

Due to market conditions stemming from COVID-19, entities may choose to sell or terminate a line of business, close locations, relocate business activities from one location to another, make changes in management structure, or undergo a fundamental reorganization that affects the nature and focus of operations. These activities represent exit activities accounted for under ASC 420, *Exit and Disposal Cost Obligations*. These costs include:

- Involuntary employee termination benefits pursuant to a one-time benefit arrangement that, in substance, is not an ongoing benefit arrangement or an individual deferred compensation contract.
- Costs to terminate a contract that is not a lease.
- Other associated costs, including costs to consolidate or close facilities and relocate employees.

A liability for a cost associated with an exit or disposal activity is recognized at fair value in the period in which the liability is incurred (except for a liability for one-time employee termination benefits that are

incurred over time). If fair value cannot be reasonably estimated, the liability is recognized in the period in which fair value can be reasonably estimated.

A liability for costs that will continue to be incurred under an operating lease for its remaining term without economic benefit is recognized at the cease-use date.

Additionally, with respect to discontinued operations, the criteria in ASC 205-20-45 continue to apply, such that any assessments depend on conditions at the balance sheet date. As a non-recognized subsequent event, the COVID-19 outbreak would not be relevant to these determinations as of December 31, 2019.

ICFR Considerations

Companies will need to consider how the COVID-19 pandemic may be affecting ICFR. Disruptions to a company's operations, processes, workforce, customers and suppliers should be considered in evaluating whether legacy controls continue to be designed and operating at an appropriate level to mitigate risks of a material misstatement to the financial statements. Companies should consider the impact of COVID-19 on internal controls as a result of people, process and technology changes.

People Impact

Business closures and social distancing have caused significant losses in revenue for many businesses and resulted in huge lay-offs. Companies should assess the impact on their control environment as a result of reduction in force such as loss of knowledge due to terminations or segregation of duty conflicts. Maintaining detailed documentation of procedures is important to business continuity and control effectiveness.

Process Impact

Interruptions in the company's operations and work from home may have resulted in process changes and or delays, which may impact the design or the performance of internal controls to mitigate the risk of material misstatement. Companies must reiterate the importance of maintaining the adequacy of the control design and related documentation consistently. Additionally, maintaining a checklist and setting timely reminders may assist the control owners to maintain the effectiveness of the control environment.

Technology Impact

Resiliency in technology infrastructure, applications and tools is extremely important during this time where the personnel are working remotely. It increases stress on the company's infrastructure such as Virtual Private Network (VPN) connectivity due to large volume of users and impacts performance of key applications. Security of company's sensitive data continues to be an important factor against cyberattacks due to potentially insecure home networks. Ensure appropriate IT Change Management and IT Access Management controls continue to remain effective with appropriate documentation.

If a control cannot be performed as previously designed, a company needs to make sure any changes in design address the original risks of material misstatement and any new or modified risks.

Cash Flow and Going Concern Assessments – Control considerations

Companies also may need to consider whether they need to design and operate any new controls over processes, such as a going concern assessment, that may not have required in-depth analysis in the past. Making such an assessment in the current environment, given all of the uncertainty, may require a company to perform a more detailed analysis and estimation process than it has in the past. In the current environment, companies may also need to consider whether they are able to collect all of the information they need and retain evidence that their controls are operating effectively.

Changes in Estimates – Control considerations

Accounts affected by estimation processes will need close evaluation on an interim basis. Depending on the business and industry, some of these estimation processes may be based on data that is highly subjective or likely to dramatically change in the future. Companies will need to conduct a robust and thoughtful evaluation process to make sure they have appropriate internal controls in place to adequately identify and evaluate known facts and circumstances when developing their estimates. The operation of estimation process controls will likely need to consider new inputs and assumptions in connection with challenges caused by the COVID-19 pandemic. Given the significant disruptions to business activity in several industries and the uncertainty about the duration of these disruptions, companies will need to focus on controls to determine the completeness and accuracy of relevant, available information to make estimates. Historical tolerances or sensitivities in internal controls may need to be revised to address changes in the current environment, and contrary evidence will need to be considered.

Disclosure Controls

Companies will also need to make sure their disclosure controls are operating effectively so they can produce thoughtful and robust disclosures. SEC registrants need to consider whether they have made any changes to the design of their ICFR that has materially affected, or is reasonably likely to materially affect, their ICFR and would, therefore, need to be disclosed in Form 10-Q or Form 10-K. Controls that now operate virtually and are performed by people who work from home may adversely affect a company's ability to maintain operations, including financial reporting systems, ICFR and disclosure controls and procedures. Determining what constitutes a material or reasonably likely material change in a control during the current period will require careful consideration.

Finally, companies should hold timely discussions with their audit committees and auditors to make sure their financial reporting and review processes are robust and practical, considering the circumstances.

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