Centri

Coronavirus Update

SHARE

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# Exit or Disposal Activities Due to COVID-19

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:

1. 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.
2. Costs to terminate a contract that is not a lease.
3. 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. The COVID-19 outbreak would be relevant to these determinations as of June 30, 2020.

If a company has no written severance plan, and has not historically established a substantive on-going plan through multiple prior termination events, the severance benefits to be provided to the impacted employees would be considered a one-time termination benefit accounted for under ASC 420-10.

In that scenario, the date management commits to the plan and determines the impacted employees and benefits to be paid is still important, as no severance cost may be recognized prior to that date. However, if the employees are required to continue providing service for a period of time after the decision to terminate is made by management, then the related expense must be recognized over that period.

Costs associated with one-time employee termination benefits are measured at the time employees receive communication of the termination (in accordance with ASC 420-10-25-4) and are either recognized on the communication date or over the service period, depending on whether future services are required (in accordance with ASC 420-10-25-8 to 25-9). A liability for costs associated with closing a facility and relocating employees is not recorded until the costs are incurred.

For entities that have adopted ASC 842, ASC 420 does not apply to terminated contracts that are leases. Therefore, when a company ceases to use an asset being leased, it will evaluate the recognized right-of-use asset for impairment in accordance with ASC 360. However, if an entity has not yet adopted ASC 842, it will apply the guidance in ASC 420 and recognize a liability for the costs that will continue to be incurred under an operating lease for its remaining term without economic benefit to the entity. These costs are recognized and measured at fair value when the entity ceases using the right conveyed by the lease.

It is important to note that the costs associated with temporarily vacating a facility are not subject to ASC 420. An evaluation of whether an entity has ceased using a facility permanently or temporarily is based on the facts and circumstances.

## Disclosure requirements

The disclosure required by ASC 420-10-50 include:

- A description of the exit or disposal activity, including the facts and circumstances leading to the activity and the completion date
- For each major type of costs, (i.e. One-time employee termination costs, contract termination costs, or other associated costs) the amount expected to be incurred in connection with the activity, the amount incurred in the period and the cumulative amount to date
- A reconciliation of the beginning and ending liability showing separately the costs incurred and charged to expense, costs paid or otherwise settled, and any adjustments
- The income statement line item or items that the activity costs were aggregated
- Amounts attributable to reportable segments as defined in ASC 280-10
- If a liability associated with the cost of the activity is not recognized because the fair value cannot be reasonably estimated, the fact and reasons why

The disclosure requirement is ongoing and required for subsequent periods until the activity is completed.

## Internal control over financial reporting

Companies will need to consider how restructuring activities may be affecting ICFR. Disruptions to a company's operations, processes, and workforce 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 restructuring on internal controls as a result of people, process and technology changes. A re-evaluation of materiality thresholds to assess financial statement line items that may now be brought into scope and were previously deemed out of scope. Business closures and social distancing have caused significant losses in revenue for many businesses and resulted in significant lay-offs. Companies should assess the impact on their control environment as a result of a reduction in the workforce, such as the loss of knowledge due to terminations or segregation of duty conflicts. Additional internal considerations should include an impairment assessment of fixed assets or intangibles such as Goodwill and an impact on bad debt reserves due to customer non-payment or delays. Increased risk of fraud and cyber risk is also an important consideration as an impact of exit activities of a revenue stream or a reportable segment. Maintaining detailed documentation of procedures is important to business continuity and control effectiveness.

Interruptions in the company's operations 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.