Raymond Chabot Grant Thornton

Assurance

News

Discussions

Flash – ASPE and ASNFPO

COVID-19: Accounting Implications for Years Ended On or After March 31, 2020

May 2020

The novel coronavirus (COVID-19) pandemic continues to have a significant impact on our economy, including consumption, production and supply chain disruptions. Despite encouraging signs, the business environment remains highly uncertain. Entities need to carefully consider the accounting implications resulting from this still uncertain situation.

This edition of *Flash* presents accounting implications and identifies key financial reporting areas that entities should consider when determining the potential impact of the COVID-19 pandemic on their business and, on the results, financial position and disclosures in their financial statements prepared in accordance with accounting standards for private enterprises (ASPE) or accounting standards for not-for-profit organizations (ASNFPO). It also discusses the recent decision of the Accounting Standards Board of Canada (AcSB) to defer the effective dates of several amendments to standards in light of the COVID-19 pandemic.

Accounting implications of the COVID-19 pandemic

For years ended on or after March 31, 2020, the impacts of COVID-19 pandemic must be considered by entities when preparing their financial statements as most Canadian entities started to be affected by COVID-19 in March 2020. This pandemic could alter the recorded amounts of an entity's assets, liabilities, revenues and expenses in a variety of ways.

In the **Appendix** to this *Flash*, you will find a table identifying key financial reporting areas that entities need to consider when determining the potential impact of the COVID-19 pandemic on their business and, on the results, financial position and disclosures in their financial statements prepared in accordance with ASPE or ASNFPO for years ended on or after March 31, 2020.

For fiscal years ended on or before December 31, 2019, the impact of COVID-19 pandemic is generally considered a non-adjusting subsequent event. This would also be considered as such for fiscal years ended January 31, 2020 or February 29, 2020, except in cases where the entity or one of its components operated in an environment where the effects of the pandemic already had an impact on its operations. For example, an entity with a subsidiary in an area that already had a high number of infections at those dates.

Our thoughts

The list of the potential impacts of the COVID-19 pandemic on an entity's business and financial statements is daunting. Although the accounting standards already provide guidance on how to deal with many of these, entities will be challenged to address these issues while managing their businesses in this difficult time. Contact your Raymond Chabot Grant Thornton advisor if you have any questions about the potential impact and how we can help determine the actual impact on your entity.

Although the COVID-19 pandemic will require consideration of a variety of issues when preparing an entity's financial statements, we believe the three following issues will require particular attention from entities and financial statement preparers.

Impairment of assets

Accounting standards require that long-lived assets be tested for recoverability whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. We think that the current situation may have caused such events to occur for many entities and careful consideration should be given to the need to recognize impairment losses for assets due to COVID-19.

Debt covenants and ratios

Accounting standards require that long-term debt with a measurable covenant violation be classified as a current liability unless specific conditions are met. The recorded amounts on an entity's assets, liabilities, revenues and expenses could be affected by the pandemic and consequently lead to the non-respect of an entity's financial statement ratios and covenants. We expect many entities may be required to re-classify their long-term debt as current due to the violation of such covenants or ratios.

Going concern

Accounting standards require management to perform an assessment of the entity's ability to continue as a going concern. In the situation where management intends or has no other realistic alternative but to liquidate the entity or to cease trading, the going concern basis is not appropriate for the preparation of the financial statements. If the going concern basis is not appropriate, another basis must be used, which is often the liquidation basis. At present, we believe that there are realistic alternatives to liquidation for most entities, especially following announcements of assistance for entities from governments and other players in the financial sector. However, the COVID-19 pandemic may cause material uncertainties related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, such as contracting gross or operating margins due to slowed or stopped production without the ability to reduce fixed costs. Accounting standards require disclosure of such uncertainties in the financial statements, and we believe that such disclosure will be more prevalent until there is greater certainty about the economic recovery.

Deferral of effective dates of amendments to standards

Recognizing that the challenges of continuing to operate in the current environment limit the time stakeholders have to consider ongoing projects and implement newly issued standards, the AcSB decided at its April 15, 2020 meeting to defer the effective dates of the following amendments effective for years beginning on or after January 1, 2020, by one year to January 1, 2021:

- Amendments to Section 3051, Investments;
- Amendments to Section 3465, Income Taxes; and
- Amendments to Section 3856, Financial Instruments.

The AcSB is also deferring the effective dates of new Section 3041, Agriculture, and amendments to Section 3400, Revenue, effective for years beginning on or after January 1, 2021, by one year to January 1, 2022. However, early adoption of each of these amendments and new Section 3041 continues to be permitted.

Our thoughts

We welcome the AcSB's decision to defer the effective dates. Many of the amendments are significant and complex. While numerous entities may have started analyzing the impacts of adopting some of the amendments, this deferral will permit entities to focus on more immediate business and financial reporting needs, including assessing and reporting the impacts of the COVID-19 pandemic.

Although the deferral will alleviate pressure on entities to complete their plans for adopting the amendments in the short-term, we strongly encourage them not to delay too long. Contact your Raymond Chabot Grant Thornton advisor if you have any questions about these amendments and how we can help identify the potential impact of their application.

Appendix – Key financial reporting areas

Please refer to the authoritative guidance for each topic and consider the facts and circumstances specific to your entity when assessing potential impacts. This is not an exhaustive list and there may be other areas not included in this publication that your entity should consider. In addition, the topics presented are not necessarily listed in order of importance.

Potential impact of COVID-19 pandemic	ASPE/ASNFPO reference
Going concern	
■ At each reporting date, management is required to assess the entity's ability to continue as a going concern and, to do so, it shall consider all available information about the future, which is, at least, but not limited to, 12 months from the balance sheet date. • If management intends or has no realistic alternative but to liquidate the entity or to cease trading, the going concern basis is not appropriate and the financial statements will have to be prepared on another basis, e.g. a liquidation basis. • If there are material uncertainties about the entity's ability to continue as a going concern, the entity should include going concern disclosures in the notes to its financial statements. ■ The going concern assessment should also take into account the effect of subsequent events to the financial statement date as they may be so pervasive that the viability of the whole or a part of the entity's business could be brought into question. For example, a rapid deterioration in operating results or financial position after the financial statement date may indicate a need to consider whether the going concern assumption remains appropriate or whether there is now material uncertainties about the entity's ability to continue as a going concern that needs to be disclosed.	■ Section 1400, General Standards of Financial Statement Presentation ■ Section 1401, General Standards of Financial Statement Presentation for Not-for-Profit Organizations ■ Section 3820, Subsequent Events
Impairment of long-lived assets, intangible assets and goodwill	
■ The pandemic may cause indicators of possible impairment requiring an impairment test, for example: • Reduced/suspended operations • Reduced demand • Decline in selling prices ■ If an impairment test is required (ASPE): • An impairment loss is recognized when the carrying amount of an asset is not recoverable and exceeds its fair value. • Cash flow forecasts must be updated to reflect the impact of the pandemic. • Discount rates need to be updated and reflect revised risk of cash flows. • A goodwill impairment loss recognized during a period cannot be subsequently reversed, even if situation subsequently improves. ■ If an impairment test is required (ASNPO): • The net carrying amount of the asset should be written down to the asset's fair value or replacement cost.	■ Section 3063, Impairment of Long-Lived Assets ■ Section 3064, Goodwill and Intangible Assets ■ Section 4433, Tangible Capital Assets Held by Not-for-Profit Organizations ■ Section 4434, Intangible Assets Held by Not-for-Profit Organizations ■ Section 4441, Collections Held by Not-for-Profit Organizations

Potential impact of COVID-19 pandemic	ASPE/ASNFPO reference
Impairment of financial assets (accounts receivable, loans receivable)	
▪ Impairment is recognized if a debtor is specifically affected at balance sheet date and collection is doubtful. ▪ Possible need to reconsider assumptions used in determining allowances as historical data may no longer be relevant for assessing future collections given debtors' increased financial difficulty resulting from the pandemic (e.g. reduced or suspended operations).	▪ Section 3856, Financial Instruments
Impairment of investments accounted for at cost or using the equity method	
▪ The pandemic may cause indicators of possible impairment requiring an impairment test, for example: • Significant financial difficulty of investee; • Probable that investee will enter bankruptcy or other financial reorganization; • Economic instability in investee's industry. ▪ If an impairment test is required: • Reduce carrying amount of the investment to the higher of (i) the present value of the cash flows expected to be generated by holding the investment, discounted using a current market rate of interest appropriate to the asset and (ii) the amount that could be realized by selling the asset at the balance sheet date.	▪ Section 3051, Investments ▪ Section 4450, Reporting Controlled and Related Entities by Not-for-Profit Organizations
Financial assets measured at fair value (e.g. equity investments) and financial liabilities measured at fair value (e.g. derivatives)	
▪ Fair value must reflect market participant views and market data at the measurement date under current market conditions. There may be an increase in the amount of subjectivity involved in fair value measurements, especially those based on unobservable inputs. In some cases, greater use of unobservable inputs will be required because relevant observable inputs are no longer available (e.g. no recent comparable market transactions).	▪ Section 3856, Financial Instruments
Inventory valuation	
▪ Measurement at the lower of cost and net realizable value • Write-downs may be required due to decreased selling prices, a lower inventory turnover, obsolescence, spoilage, damage caused by reduced demand or suspended operations. ▪ Inventory costing • The allocation of fixed production overheads is based on the normal capacity of the production facilities. The amount of fixed overhead allocated to each unit of production is not increased because of low production or idle plant. Unallocated overheads are expensed.	▪ Section 3031, Inventories ▪ Section 3032, Inventories Held by Not-for-Profit Organizations

Potential impact of COVID-19 pandemic	ASPE/ASNFPO reference
Prepaid expenses	
■ There may be prepaid expenses related to services or activities that are no longer expected to be received. These prepaid expenses may need to be written-off.	■ Section 1000, Financial Statement Concepts ■ Section 1001, Financial Statement Concepts for Not-for-Profit Organizations
Income taxes	
■ Recoverability of future income tax assets: • A significant weakening of an entity's financial position may indicate that the entity will not be able to generate sufficient taxable income to allow recognized future income tax assets to be realized, in which case the future income tax asset is reduced to the amount that is considered more likely than not to be realized. ■ New government tax laws, incentives and credits, as well as changes to existing ones, need to be considered. ■ Adjustments to the financial statements due to pandemic as explained elsewhere in this document may impact the amount of future income tax assets and liabilities.	■ Section 3465, Income Taxes
Insurance claims	
■ Gains from insurance claims (e.g. business interruption insurance) are only recognized when they are realized.	■ Section 3290, Contingencies
Debt modification and classification	
■ Some creditors may provide debtholders with the option to defer principal payments for a period of time or forego interest payments. Entities will need to assess whether the change in terms represents a modification or extinguishment of the debt obligation and revisit the portion of the debt that is considered current versus non-current. ■ Debt covenants may be breached and if no waiver is obtained from creditors, debt should be classified as a current liability.	■ Section 3856, Financial Instruments ■ Section 1510, Current Assets and Current Liabilities
Measuring defined benefit assets or liabilities	
■ Entities will need to perform a new actuarial valuation, including updating assumptions if they have settled their obligations, or have significantly reduced the number of active employees or the expected years of future service of active employees. However, 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. ■ Plan assets are remeasured at the balance sheet date.	■ Section 3462, Employee Future Benefits ■ Section 3463, Reporting Employee Future Benefits by Not-for-Profit Organizations

Potential impact of COVID-19 pandemic	ASPE/ASNFPO reference
Restructuring, termination benefits, future operating losses and onerous leases	
■ Entities may decide to close facilities and/or terminate employees: • An entity may not record a restructuring provision. • A provision may need to be recognized for termination benefits, if certain conditions are met. ■ Entities may expect a period of operating losses. Liabilities cannot be recognized for future operating losses. ■ Lessees may cease using a leased asset but continue to incur lease costs for the remaining term of the lease without economic benefit to the entity. An entity may have to recognize a liability when the entity ceases to use the leased asset.	■ Section 3290, Contingencies ■ Section 3462, Employee Future Benefits ■ Section 3463, Reporting Employee Future Benefits by Not-for-Profit Organizations
Government assistance	
■ Governments are implementing various programs to provide financial assistance to entities. The substance of each of these programs will need to be understood and analyzed to determine the appropriate accounting treatment and timing of recognition of the assistance.	■ Section 3800, Government Assistance ■ Section 4410, Contributions — Revenue Recognition
Revenue recognition	
■ Revenue can only be recognized if collection is reasonably assured. The ability of potential customers to pay amounts that would be owing under sales contracts must be assessed, even for recurring customers, as their financial condition may evolve over time as a result of the pandemic and available government financial assistance. ■ Entities may begin offering price concessions and rebates to increase sales. Entities will need to assess the impact of store closures on their refund/return policies and estimates. Historical data should be questioned as to whether it is still a relevant indicator of future return behaviour. ■ Losses on contracts accounted for using the percentage of completion method should be recognized when the total estimated contract costs are greater than the expected revenue.	■ Section 3400, Revenue ■ Section 4410, Contributions — Revenue Recognition ■ Section 4420, Contributions Receivable
Foreign currency translation	
■ As a practical expedient, entities may translate revenue earned and expenses incurred in a foreign currency using an average rate (e.g. a monthly or annual average).The use of an average rate should be revisited if significant fluctuations in exchange rates occurred during this period of economic uncertainty.	■ Section 1651, Foreign Currency Translation
Hedge accounting	
■ An entity may have to discontinue hedge accounting, for example, if the following situations occur: • The hedged item is an anticipated transaction and it is no longer probable that the anticipated transaction will occur at the time or in the amount designated. • Market volatility could result in the critical terms of the hedging item and the hedged item to no longer be the same.	■ Section 3856, Financial Instruments

Potential impact of COVID-19 pandemic	ASPE/ASNFPO reference
Stock-based compensation	
■ Given the current economic environment, entities may have laid off employees or changed the terms of stock-based payment awards. In addition, the likelihood that performance vesting conditions outlined in the awards arrangements will be met in the future may have changed. Entities will need to determine whether any of these changes could impact the accounting for the awards. ■ A cancellation of stock-based payment awards, even if the vesting conditions are unlikely to be satisfied, may result in the immediate recognition of any unrecognized expense.	■ Section 3870, Stock-Based Compensation and Other Stock-Based Payments
Contingent consideration	
■ Subsequent measurement and accounting for contingent consideration: • An entity may wish to decrease the amount of a contingent consideration liability initially recognized at fair value as part of a business combination if the contingency (e.g. earning's target, etc.) on which the fair value had originally been established are now less optimistic. Section 1582 prohibits any subsequent downward (or upward) revaluation of a contingent consideration until the contingency is resolved. Until the contingency is resolved however, the entity may be required to provide information on any contingent gain (or loss) in accordance with Section 3290.	■ Section 1582, Business Combinations ■ Section 3290, Contingencies
Disclosure	
■ Many of the impacts of COVID-19 pandemic affecting the recorded amounts of an entity's assets, liabilities, revenues and expenses will require certain disclosures in the notes to the financial statements. These required disclosures are included in each of the relevant accounting standards.	■ Various
Subsequent events	
■ Events occurring between the date of the financial statements and the date of their completion must be assessed to determine whether they provide additional evidence relating to conditions that existed at the date of the financial statements. If yes, the financial statements should be adjusted. If not, note disclosures may be required.	■ Section 3820, Subsequent Events

Follow us

rcgt.com

Raymond Chabot Grant Thornton