



# New Developments Summary

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## COVID-19 pandemic

Accounting and financial reporting considerations

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The World Health Organization (WHO) declared the outbreak of COVID-19 a pandemic on March 11, 2020. The state of the pandemic is rapidly evolving, and the disease is taking a tragic toll on human life across the world. Additionally, the disease is impacting the global economy, including disruptions in supply chains, curtailment of consumer spending, unavailable employees or layoffs, and increasing volatility in the capital markets. The pandemic may have a far-reaching impact on many entities, both directly and indirectly, as well as on accounting, disclosure, and internal controls for many entities.

## A. Accounting considerations

Entities are often required by U.S. GAAP to make assumptions about the economic consequences of disruptive biological, environmental, social, and political events when making a variety of accounting estimates. However, forecasting the magnitude and duration of the economic impact of such events is often challenging.

Accounting estimates rely on an entity's judgmental assumptions, which must be based on a reasonable interpretation of conditions or events that are either known or knowable as of the measurement date. In other words, the assumptions used by an entity in its estimates must be both reasonable and supportable.

Determining what constitutes a reasonable and supportable assumption during times of economic uncertainty requires an entity to exercise professional judgment grounded in a well-controlled and supported estimation process. A well-controlled and supported estimation process includes

- Identifying information relevant to the estimate that is reasonably known or knowable as of the measurement date. This may include identifying related information after the measurement date, but before the financial statements are either issued or made available to be issued.
- Interpreting identified relevant information to produce a reasonable and supportable forecast of future conditions.
- Utilizing the reasonable and supportable forecast of future conditions in the approach used to arrive at a quantitative estimate.
- Producing transparent and robust disclosures describing the key inputs and assumptions used in the entity's estimation approach.

### Subsequent events

Entities may become aware of pandemic-related events after the balance-sheet date, but before the financial statements are either issued or available to be issued. Such events may include disruptions to the entity's supply chains (or the supply chains of their customers), bankruptcy of customers, or government actions that could impact either the entity's or their customers' activities. The guidance on subsequent events in ASC 855-10-25-1 requires an entity to evaluate whether those events provide evidence about conditions that existed at the balance-sheet date, and to consider all information that becomes available before the financial statements are either issued or available to be issued. To the extent that identified pandemic-related events provide evidence about conditions that existed as of the balance-sheet date, an entity needs to adjust its financial statements to reflect the impact of such events. On the other hand, to the extent that pandemic-related events do not provide evidence about conditions that existed at the balance-sheet date, entities may consider whether it is necessary to disclose the nature of the event and an estimate of its impact on the financial statements (or a statement indicating that such estimate cannot be made) to prevent the financial statements from being misleading.

Although the first known case of COVID-19 was reported to the WHO on December 31, 2019, the likelihood of it becoming a pandemic and its potential impact on the global economy was largely unknown. Therefore, we generally believe that the pandemic constitutes a nonrecognized subsequent event with regard to financial statements with a balance sheet date on or before December 31, 2019.



### Grant Thornton insights: SEC focuses on subsequent events and COVID-19

Entities will need to carefully consider whether to provide disclosure regarding the impact of the pandemic on their business. Given the widespread impact of the pandemic on both the global and U.S. economy, many entities will need to provide disclosures regarding the pandemic's impact.

In fact, in two recent public statements, the SEC emphasized the importance of transparent and informative disclosures about the impact of the COVID-19 pandemic on an entity's operations and financial results.

On January 30, 2020, SEC Chairman Jay Clayton [commented](#) that while the effect of COVID-19 might be "difficult to assess or predict with meaningful precision," this difficulty should not prevent entities from providing disclosures about the impact of the pandemic. "[H]ow issuers plan for that uncertainty and how they choose to respond to events as they unfold can nevertheless be material to an investment decision," he noted.

Additionally, on February 19, 2020, Chairman Clayton, SEC Division of Corporation Finance Director Bill Hinnman, SEC Chief Accountant Sager Teotia, and PCAOB Chairman William D. Duhnke III issued a [joint public statement](#) that emphasized "(1) the need to consider potential disclosure of subsequent events in the notes to the financial statements...and (2) [the SEC's] general policy to grant appropriate relief from filing deadlines in situations where, in light of circumstances beyond the control of the issuer, filings cannot be completed on time with appropriate review and attention." The SEC has provided conditional relief and assistance to entities affected by COVID-19. See Section B, "Disclosures" for further discussion.

The SEC has summarized its response to the COVID-19 pandemic [here](#).

## Asset impairment

The impact of the pandemic on entities may manifest in a variety of ways, including reduced revenue, supply chain disruptions, temporary business closures, increased exposure to customers' credit risk, or increased costs. These could be indicators of asset impairment, even over a relatively short duration, which entities need to consider.

### ***Impairment of goodwill***

The guidance in ASC 350-20-35-30, *Intangibles – Goodwill and Other*, requires entities to test goodwill for impairment if "an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount." As a result, an entity should consider the direct and indirect impact of the pandemic to determine whether it is an event that requires an entity to test goodwill for impairment.

### ***Long-lived assets***

The guidance on property, plant, and equipment in ASC 360-10-35-31 requires entities to evaluate long-lived assets "for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable." Entities may need to consider whether the direct and indirect impact of the pandemic constitutes an event that would require testing long-lived assets for recoverability, such as (a) a significant decrease in the market price of the long-lived assets, (b) a significant adverse change in

the extent or manner in which its long-lived assets are being used or their physical condition, or (c) a significant adverse change in the business climate that could affect the value of the long-lived assets.

The impairment requirements in ASC 360 also apply to right-of-use assets recognized by lessees on leasing transactions accounted for under ASC 842, *Leases*.

### ***Inventory***

The impact of the pandemic on consumer and business spending might also affect the value of an entity's inventory, which may require the entity to remeasure its inventory. The guidance in ASC 330, *Inventory*, requires that inventory measured using either the last-in, first-out method or the retail method is measured at the lower of cost or market, while inventory measured using all other methods, such as first-in, first-out or average cost, is measured at the lower of cost or net realizable value.

Additionally, entities may experience temporary closings or supply chain disruptions that result in inventory production levels dropping below normal capacity. Fixed overhead cost allocations to individual units of production should generally not increase as a result of this "excess capacity," but should generally be expensed in the period they are incurred.

## **Fair value measurement and impairment of financial assets**

### ***Fair value***

The pandemic of COVID-19 has caused a significant downturn in financial markets globally. Accordingly, entities need to consider the impact of significant market fluctuations in determining the fair value of financial assets that are subject to fair value measurements. Entities need to consider the guidance in ASC 820, *Fair Value Measurement*, considering the direct and indirect impact of the pandemic on the fair value of its investments, including changing credit spreads, implied volatility, and market liquidity.

### ***Impairment of financial assets***

Financial assets that are not carried at fair value, with changes in fair value recognized in earnings, are generally subject to one of several impairment models, including the other-than-temporary impairment model that applies to debt securities under ASC 320 and equity method investments under ASC 323, as well as the measurement alternative that may be elected on equity investments without a readily determinable fair value under ASC 321 and loans and receivables under ASC 310. Entities need to carefully identify the appropriate impairment model and consider if the pandemic affects whether an impairment should be recognized and, if so, the extent of the impairment.

See [New Developments Summary 2016-03](#) for more information on accounting for equity securities under the measurement alternative.

### ***Equity method investments***

The guidance in ASC 323 requires an entity to recognize impairment losses on equity method investments when a decline in fair value below the investment's carrying amount is other than temporary. An entity is required to evaluate whether such an impairment of an equity method investment is other than temporary when it becomes aware of evidence that an impairment may exist (that is, when a "triggering event" occurs). Such evidence includes

- The investee incurs a series of operating losses.
- The investor cannot recover the carrying amount of the investment.

- The investee cannot sustain its historical level of earnings.
- The current fair value of the investment is less than its carrying amount.
- Other investors have ceased providing support to the investee or otherwise reduced their financial commitment to the investee.
- The investee has recognized impairment losses on its assets.

Entities with material equity method investments must have a process to identify whether such evidence exists, considering the impact of the pandemic on these factors. An entity that concludes the impairment of its equity method investment is other than temporary should write the investment down to its fair value. Entities with basis differences on equity method investments should carefully consider the guidance about the treatment of basis differences in ASC 323.

### ***The current expected credit loss model***

ASU 2016-13 introduced a new topic to the FASB Codification, ASC 326, *Credit Losses*, and the current expected credit loss (CECL) model to U.S. GAAP. The CECL model requires that entities base their expectation of lifetime credit losses on financial instruments measured at amortized cost on historical loss experience, adjusted for current conditions and reasonable and supportable forecasts of future conditions. Entities that have already adopted the CECL model must consider the impact of the pandemic on their reasonable and supportable forecasts used to estimate expected credit losses on financial assets measured at amortized cost.

In particular, entities may determine that the period over which they can reasonably and supportably forecast future conditions might be shorter in a period marked by significant economic uncertainty. Additionally, for financial assets whose contractual lives exceed the entity's reasonable and supportable forecast period, the entity is required to revert to its historical loss experience, using a pattern of reversion that results in the best overall estimate of expected credit losses. Entities may also need to evaluate their pattern of reversion as a result of the economic impact of the pandemic.

Many commercial entities that have already adopted the amendments in ASU 2016-13 whose primary exposure to financial assets is short-term trade accounts receivable or contract assets may not have anticipated a significant change in their accounting for uncollectible receivables under the new CECL model. However, even such commercial entities must have a process for evaluating whether their reasonable and supportable forecast of future conditions indicates that their historical credit loss experience must be adjusted, such as for the impact of the pandemic.

See [New Developments Summary 2016-10](#) for more information about the requirements under ASC 326.

## **Leases**

Lessors in sales-type and direct financing lease arrangements should follow the guidance on the impairment of financial assets in ASC 310 or 326, as applicable, when assessing whether the pandemic has impacted the credit losses on lease receivables.

Lessors in operating lease arrangements accounted for under ASC 842, however, need to consider whether it is no longer probable that it will collect the lease payments and any residual value guarantee from a lessee due to the pandemic's impact. Under the guidance in ASC 842-30-25-13, if it is no longer probable that the lessor will collect the lease payments and any residual value guarantee from a lessee, the lessor should recognize a current-period adjustment to lease income equal to the difference between (a) the income that would have been recognized if collection were probable, including variable lease

payments, and (b) the lease payments, including variable lease payments, that have been collected to date. As long as collectibility is not probable, a lessor's operating lease income is limited to lease payments, including variable lease payments, collected from the lessee.

In response to operational disruptions, such as temporary retail store closings, lessors and lessees might agree to modify their lease arrangements. For lease modifications that change the amount of consideration stated in the contract, ASC 842 requires a lessee to reassess lease classification, to remeasure and reallocate the consideration in the contract to the lease and nonlease components (unless the lessee elects to combine the components), and to recognize the adjustment to the lease liability, with an offsetting adjustment to the right-of-use asset.

Similarly, ASC 842 requires a lessor to reassess lease classification and to remeasure and reallocate the consideration in the contract for a lease modification that is not accounted for as a separate contract. The accounting entries depend on how the lease is classified both before and after the modification. For an operating lease that is modified in such a way that it remains an operating lease, it is important to note that a lessor should consider any prepaid or accrued rent associated with the original lease as part of the lease payments under the modified lease.

Finally, the determination of an entity's incremental borrowing rate (IBR) is an important aspect of lease accounting under ASC 842. Entities need to evaluate whether the economic impact of the pandemic has impacted their IBR and, if so, the impact on their lease accounting. If a lease is modified in a manner that does not constitute a new separate lease, a lessee must remeasure its lease liability based on its IBR on the modification date, assuming that the IBR is used as its discount rate for measuring its lease liability under ASC 842.

Please see our comprehensive guide on lease accounting, [Navigating the guidance in ASC 842](#), for further information.

## Hedge accounting

Entities that have hedged forecasted transactions in a cash flow hedge under the guidance in ASC 815, *Derivatives and Hedging*, may need to consider whether the forecasted transactions are still probable of occurring in light of the impact of the pandemic.

If an entity determines that a hedged forecasted transaction is no longer probable of occurring, then the entity should discontinue cash flow hedge accounting for that forecasted transaction under the guidance in ASC 815. If an entity determines that it must discontinue cash flow hedge accounting, its subsequent accounting for any amounts associated with the hedge that are deferred in accumulated other comprehensive income will depend on the likelihood that the forecasted transaction will occur. If it is probable that the forecasted transaction will not occur, then the entity must immediately reclassify to earnings any amounts previously recognized in accumulated other comprehensive income. Otherwise, amounts in accumulated other comprehensive income associated with a discontinued cash flow hedge should be recognized in earnings when the forecasted transaction affects earnings.

## Revenue recognition and variable consideration

Under the revenue recognition guidance in ASC 606, entities entering into contracts with customers that include variable consideration (for example, discounts or price concessions) are required to estimate the amount of consideration to which they will be entitled in exchange for transferring promised goods or services. Entities should include variable consideration in the transaction price only to the extent that it is probable a significant reversal of cumulative revenue recognized will not occur when any related uncertainties are resolved. Variable consideration that is not included in the transaction price at contract

inception (known as “constrained” revenue) is subsequently included when either (a) it becomes probable that a significant reversal will not occur, or (b) the uncertainty related to the variable consideration is resolved.

Entities that enter into contracts with variable consideration must update their estimates of variable consideration over the life of the contract based on facts and circumstances that are known or knowable at each reporting date. As a result, an entity may need to consider the impact of the pandemic on its estimate of variable consideration. Entities may also need to provide incremental disclosures about the impact of the pandemic on revenue recognition, including the methods, inputs, and assumptions used for estimating variable consideration and amounts that are constrained. Entities need to consider whether to revise their disclosures about the judgments and changes in judgments that impact the determination of the amount and timing of revenue recognition.

Please see our comprehensive guide on revenue recognition, [Revenue from Contracts with Customers: Navigating the guidance in ASC 606 and ASC 340-40](#), for further information.

### **Modification or extinguishment of liabilities**

Entities significantly impacted by the pandemic may request accommodation from their lenders, including temporary payment deferrals, modifications to or waivers of violations of debt covenants, or changes to other terms of their debt agreements. Such accommodations are debt modifications and should be carefully evaluated to determine the appropriate accounting treatment.

When evaluating the accounting for modifying a liability, an entity should first consider whether the modification is a “troubled debt restructuring” (TDR), as defined in ASC 470-60. A modification is a TDR if (a) the borrower is experiencing financial difficulty, considering the factors in ASC 470-60-55-8, and (b) the creditor has granted a concession. Under ASC 470-60-55-10, a creditor has granted a concession if the debtor’s effective borrowing rate on the modified debt is less than the effective borrowing rate immediately prior to the modification.

If the modification is not a TDR, then entities should consider the modification and extinguishment guidance in ASC 470-50. Generally, a liability associated with term debt is considered extinguished if the present value of the cash flows on the modified debt differs by 10 percent or more from the present value of the cash flows on the original debt, with each set of cash flows discounted using the effective borrowing rate associated with the original debt.

### **Insurance recoveries**

Entities may be entitled to reimbursement for losses under various types of insurance policies as a result of the pandemic. Generally, probable insurance recoveries are recognized in advance of their receipt only to the extent of the losses previously recognized, while business interruption insurance on lost revenue is generally not recognized until received.

Please refer to our publication “[Accounting for insurance recoveries](#)” for further discussion.

### **Income taxes – indefinite reinvestment of foreign earnings**

Some entities assert that certain earnings in foreign jurisdictions are indefinitely reinvested. Under the guidance in ASC 740, *Income Taxes*, entities that have made such an assertion do not recognize a deferred tax liability for accumulated earnings and other taxable outside-basis differences that are considered indefinitely reinvested in a foreign jurisdiction. Assertions of an entity’s ability to indefinitely reinvest foreign earnings are typically supported by an analysis of the entity’s plan for reinvestment as

well as its planned sources and uses of cash, considering factors like projected working capital and long-term capital needs across various tax jurisdictions. Entities that have made such assertions need to revisit them to determine whether they remain appropriate in light of the pandemic's impact on its business.

## B. Disclosures

Entities affected by the pandemic need to consider the implications on disclosures in their financial statements. The degree of disclosure required in an affected entity's financial reporting depends on the nature, duration, and extent of the pandemic's impact on the entity. Entities need to continue monitoring developments related to the pandemic and to evaluate the appropriateness of their disclosures in light of changes caused by the pandemic.

### Contingent losses

The guidance on contingencies in ASC 450-20-25-2 requires an entity to recognize a contingent loss if (a) it is probable that the liability has been incurred as of the balance-sheet date, and (b) the amount of the loss is reasonably estimable (as either a point estimate or a range of loss). Additionally, ASC 450-20-50-2 requires that contingent losses that are at least reasonably possible are disclosed, even if the amount of the loss is not reasonably estimable.

Entities will need to consider whether events related to the pandemic indicate that it is reasonably possible they have incurred a contingent loss and to make disclosures as appropriate. For instance, an entity that provides for self-insurance for medical claims by its employees may need to consider whether it is reasonably possible that, at the measurement date, its employees have had exposure to COVID-19 that will result in additional medical claims made on the entity.

### Going concern

The guidance in ASC 205-40, *Presentation and Disclosure: Going Concern*, requires entities to evaluate their ability to continue as a going concern within one year after the financial statements are either issued or made available to be issued. An entity that concludes that there is substantial doubt about its ability to continue as a going concern, or that its plans alleviate that doubt, must provide disclosures to that effect.

An entity may need to evaluate whether its analysis sufficiently considers the impact of the pandemic when determining whether substantial doubt exists about its ability to continue as a going concern for one year after the date of the financial statements, or whether its plans alleviate substantial doubt.

### Risks and uncertainties

Under ASC 275, *Risks and Uncertainties*, entities are required to make qualitative disclosures about risks and uncertainties that could significantly impact the amounts reported in the financial statements in the near term (that is, within one year from the date of the financial statements). Entities may need to evaluate whether it is necessary to include specific disclosures related to risks and uncertainties introduced by the pandemic, including disclosures for significant accounting estimates and vulnerabilities due to concentrations in vendors or customers.

### MD&A and risk factors

In addition to disclosures in their financial statements, entities may need to provide additional disclosures about the impact of the pandemic in their SEC filings under Regulation S-X in both Management's Discussion and Analysis (MD&A) and Risk Factors.

## **MD&A**

Entities need to provide clear and understandable discussion of known trends or uncertainties that have or are expected to have a material impact on revenue, income, operations, financial condition, or liquidity in MD&A.

## **Risk Factors**

Entities also need to disclose significant risks that may impact their results and the securities they have issued. Entities should consider whether it is necessary to include specific risk factors related to the pandemic and their possible impact on their business.



### **SEC issues relief for companies affected by the COVID-19**

The SEC recently issued several Orders to provide conditional regulatory relief and assistance to entities affected by COVID-19. Please see [Snapshots 2020-05](#) and [2020-07](#) for further information.

## **C. Internal control over financial reporting**

Entities affected by the pandemic need to consider its impact on their internal control over financial reporting (ICFR), including whether new controls are necessary or if existing controls have been modified as a result. Situations related to the pandemic that may impact an entity's control environment include, but are not limited to, the following:

- Absences of personnel that execute controls due to illness, office closings, or mandated work arrangements that prevent them from executing controls as designed
- Inadequate information necessary to complete certain controls due to geographical limitations
- Changes to existing controls that may create segregation of duties issues
- New controls that may not operate for a sufficient period of time to allow management or the audit team to conclude on their operating effectiveness

New controls or modified controls that are not suitably designed or operating effectively could result in deficiencies in internal controls that aren't mitigated by other existing or new controls.

Additionally, the pandemic may impact management's ability to complete the financial statement closing process and any associated internal controls in order to prepare the financial statements in a timely fashion. Although many entities may extend their reporting deadlines, these extended timelines could introduce an increased potential for error in the financial statements related to the identification of subsequent events. An entity's controls over financial reporting also need to include controls over disclosures in the financial statements, including the adequacy of disclosing the effects of the COVID-19 pandemic and the selection and application of GAAP for accounting for and disclosing matters arising from the COVID-19 pandemic.

For public entities, any changes in internal controls that have materially affected, or are reasonably likely to materially affect, an entity's ICFR are required to be disclosed in Form 10-Q or Form 10-K of the entity's quarterly or annual filings, respectively.

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For additional information on topics covered in this document, contact your Grant Thornton LLP professional.

## Contacts



**Lynne Triplett**  
*Partner-in-Charge*  
*Accounting Principles*  
T +1 312 602 8060  
E [Lynne.Triplett@us.gt.com](mailto:Lynne.Triplett@us.gt.com)



**Kendra Decker**  
*Partner-in-Charge*  
*SEC Regulatory Matters*  
T +1 202 521 1530  
E [kendra.decker@us.gt.com](mailto:kendra.decker@us.gt.com)



**Graham Dyer**  
*Partner*  
*Accounting Principles Group*  
T +1 312.602.8107  
E [Graham.Dyer@us.gt.com](mailto:Graham.Dyer@us.gt.com)



**J.B. Yett**  
*Experienced Manager*  
*Audit Methodology &*  
*Standards Group*  
T +1 214 561 2364  
E [J.B.Yett@us.gt.com](mailto:J.B.Yett@us.gt.com)