AcSB
Accounting Standards Board

COVID-19 Resource

Private Enterprise Financial Statements (ASPE)

What you need to know (May 2020)

What's the issue?

Most private enterprises in Canada, unless they are an essential service, are experiencing a material decline in their operations or are closed due to the COVID-19 pandemic. This raises questions about how COVID-19 affects the financial statements of private enterprises in Canada. This publication addresses some of the financial reporting considerations for these enterprises. For additional detail on topics such as Going Concern, Subsequent Events, Debt Modifications, and Impairment, in-depth resources are also available.

What are the COVID-19-related financial reporting considerations for private enterprises in Canada?

For private enterprises applying Part II of the CPA Canada Handbook – Accounting, the following are some of the considerations as they prepare their financial statements:

1. **Going concern:** As COVID-19 continues to disrupt private enterprises in Canada, an enterprise must assess its ability to continue as a going concern. Broadly speaking, "going concern" means that an enterprise has the resources it needs to continue operating for the next 12 months. These resources may include sufficient cash flows from operations or access to financing to help fund its operations.

   An assessment of going concern may consider, forecasts for the next fiscal year that factor in the effects of COVID-19. Section 1400, *General Standards of Financial Statement Presentation,* provides guidance on the factors to consider when assessing the ability of an enterprise to continue as a going concern. Refer to "Going Concern and Liquidity Risk (ASPE)" for additional details.

2. **Measurement of assets:** The effects of COVID-19 such as business closures and extended social distancing measures may affect the measurement of assets. Some examples are:

   (a) *Valuation of inventory*: Inventories are measured at the lower of cost or net realizable value (NRV). The slowdown in sales or the closure of operations could result in the cost of inventory exceeding NRV. For example, a manufacturing enterprise may be unable to sell existing inventory to retailers or wholesalers before the inventory turns obsolete or its retail value falls below cost. A decline in the inventory's value could result in a write-down or write-off of that inventory. Section 3031, *Inventories*, provides guidance for how to assess the NRV of inventory.

   (b) *Impairment of long-lived assets*: Long-lived assets (e.g., property, plant and equipment, intangible assets with a finite life, or long-term prepaid assets) are impaired when their carrying amount exceeds fair value. These assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Enterprises should consider whether COVID-19 triggers a need to assess the recoverability of long-lived assets. For example, is there a significant decrease in the market price or demand for the enterprise's goods or services? Similarly, does prolonged social distancing change how the asset is being used? Section 3063, *Impairment of Long-Lived Assets*, provides guidance on when and how to test for recoverability. Refer to the resource "Impairment of Long-Lived Assets (ASPE)" for additional details.

   (c) *Impairment of goodwill or intangible assets*: Goodwill and intangible assets with an indefinite life are tested for impairment when events or changes in circumstances indicate that the carrying amount may exceed fair value. Enterprises should consider whether COVID-19 triggers a need to assess the recoverability of goodwill or intangible assets with an indefinite life. For example, has the pandemic significantly reduced the demand for an enterprise's goods or services? Alternatively, have social distancing or other restrictions affected the enterprise's ability to operate? Section 3064, *Goodwill and Intangible Assets*, provides guidance on when and how to test for recoverability. Refer to the resource "Impairment of Goodwill or Intangible Assets (ASPE)" for additional details.

   (d) *Impairment of investments in subsidiaries, significantly influenced entities, and jointly controlled enterprises*: Similar to other long-term assets, enterprises must assess whether there are indications that an investment may be impaired. For example, has an extended business closure resulted in significant financial difficulty for the investee? Similarly, is it probable that an investee may enter bankruptcy or other financial reorganization? When there are impairment indicators, an impairment test is performed to determine if the investment measured using the cost or equity method is impaired. Section 3051, *Investments*, provides guidance on when and how to test investments for impairment and whether an impairment loss can be reversed in a future period.

   (e) *Impairment of financial instruments*: Generally, financial instruments are measured at cost or fair value. The effects of COVID-19 may have adversely affected the value of those financial instruments. A common example of a financial instrument that may be affected is accounts receivable. Enterprises should consider whether accounts receivable remain collectible by analyzing factors such as missed payments or financial difficulty of their customers. Similarly, a portion of receivables may be impaired as customers try to negotiate lower payments or settlements with their vendors. Section 3856, *Financial Instruments*, provides guidance on when and how to test financial instruments for impairment and whether an impairment loss can be reversed in a future period.

3. **Debt restructuring:** As private enterprises address COVID-19-related liquidity challenges, some may renegotiate terms of existing debt agreements or obtain waivers for debt covenants. Changes to the debt agreements require close examination to assess whether they are subject to modification or extinguishment accounting. Similarly, covenant violations could have varying implications on the financial statements. Section 3856, *Financial Instruments* and Section 1510, *Current Assets and Current Liabilities*, provide guidance on these matters. Refer to the resource “Debt Modifications and Covenants (ASPE)” for additional details.

4. **Lease modifications:** Similar to debt contracts, private enterprises may renegotiate the terms of lease agreements. These terms could include rent forgiveness or rent deferrals as private enterprises manage their cash flows during the pandemic. Section 3065, *Leases*, provides guidance on how to account for changes in the provisions of an existing lease.

   For leases accounted for by the lessee as a capital lease, changes to a lease are considered a new lease and accounted for prospectively over the remaining term of the lease. For leases accounted for by the lessee as an operating lease, lessees use judgment to determine how to account for deferred or waived payments. Enterprises should consider the nature and timing of rent deferrals or waivers to determine the appropriate accounting. For example, is it rational for any rent deferrals to be recognized over the remaining term of the lease or when they become due? Alternatively, is it rational to recognize rent waivers immediately or over the remaining term of the lease?

   For lessors, judgment is also required to determine how to account for deferred or waived payments. Lessors may consider the nature of deferrals or waivers and if there are any terms associated with those exception to determine the appropriate recognition.

5. **Government assistance:** Federal and provincial governments have released financial-aid programs to assist private enterprises in Canada. This aid could be assistance for non-capital items such as wage subsidies, rent subsidies, or forgivable loans. Section 3800, *Government Assistance*, provides guidance on how to account for different forms of government assistance.

   Government assistance for non-capital expenditures, such as a wage subsidy, are presented as either a reduction in a specific expense category, a reduction in overall expenses, or as revenue when the assistance is receivable. Enterprises should also consider which period the government assistance relates to. For example, the Canada Emergency Wage Subsidy was announced before March 31, 2020, but was legislated after March 31, 2020, with different terms. Therefore, judgment must be applied to determine whether this assistance can be recognized in the current period for an enterprise with a March 31, 2020, year-end. Refer to the resource “Subsequent Events (ASPE)” for additional subsequent event considerations.

   Forgivable loans are recognized as a grant when the enterprise becomes entitled to receive it and the enterprise does not need to wait until the loan is forgiven. Enterprises should consider whether they qualify for the forgivable loan, when the loan will be received or approved and the terms associated with it to determine when it can be recognized.

6. **Subsequent events:** Subsequent events are events that occur after the financial statement date but before the financial statements are issued. Depending on an enterprise’s year-end date, the effects of COVID-19, whether favourable or unfavourable, may require adjustments in the financial statements and/or additional note disclosure. For example, an enterprise with a March 31, 2020, year-end will

have a higher likelihood of the pandemic being an adjusting event compared to an enterprise with a December 31, 2019, year-end. Section 3820, *Subsequent Events*, provides guidance to determine whether adjustments are required to the financial statements and the types of disclosures necessary. Refer to the resource “Subsequent Events (ASPE)” for additional details.

Are there other financial reporting considerations?

While the above aspects of financial reporting are likely most common for private enterprises, other COVID-19 related considerations include:

(a) changes to accounting estimates for the amortization rate or salvage value of property, plant and equipment due to idle time from closures or reduced usage due to social distancing measures (see Section 3061, *Property, Plant and Equipment)*;

(b) changes in the allocation of overheads to the cost of inventory due to lower than normal or higher than normal production (see Section 3031, *Inventories*);

(c) effects of interest rate declines on discount rates for impairment tests (see “Measurement of assets” above for impairment), asset retirement obligations, new capital leases, or defined benefit obligations;

(d) changes to the value of defined benefit obligations due to significant declines in financial markets and declining interest rates;

(e) changes in the assumptions for timing and amount of revenue to recognize for percentage of completion contracts, multiple deliverable arrangements, and gift cards (see Section 3400, *Revenue*);

(f) remeasurement of future tax assets that are no longer realizable due to projected losses in future periods (see Section 3465, *Income Taxes*);

(g) penalties for the termination of contracts such as cancellation fees or forfeiture of prepayments; and

(h) enterprise specific disclosures of liquidity or other financial risks (see Section 3856, *Financial Instruments* and the resource “Going concern and liquidity risk (ASPE)).

Private enterprises may also consider using the guidance in *Future-oriented Financial Information* in CPA Canada Standards & Guidance. It will assist in preparing forecasts or projections to qualify for some of the financial-aid programs offered by the government.

What other resources are available?

1. Do you need more information? The following publications may provide more insight:

CPA Canada, “ASPE Alert: Subsequent Events and other considerations related to COVID-19.”

BDO, “COVID-19: Financial Reporting and Audit Implications,” March 19, 2020.