



BDO'S ACCOUNTING & REPORTING ADVISORY SERVICES ALERT

ACCOUNTING & REPORTING CONSIDERATIONS DURING, AND AS A RESULT OF, THE CORONAVIRUS OUTBREAK

MARCH 2020 / www.bdo.com

INTRODUCTION

With the continued spread of COVID-19 and its overwhelming effect on the global economy, we anticipate companies will experience complex accounting and reporting issues across multiple areas of their financial statements. Companies will need to consider whether those issues, as well as operational disruptions to their overall business, rise to the level of additional required disclosures, Management's Discussion and Analysis ("MD&A") and/or discrete accounting recognition.

The content herein is included only for informational purposes of possible issues that could present themselves. The list of possible issues is not all inclusive nor complete in its representation of other areas affecting companies.

TECHNICAL ACCOUNTING CONSIDERATIONS

Revenue Recognition

- ▶ **Contractual Obligations vs. Expected Consideration:** A Company may need to rethink how their current revenue contracts are structured before executing any new arrangements with customers if obligations that are to be performed by the Company begin to outweigh the expected consideration to be collected from customers. For example, if a Company has always included professional services free-of-charge with the promised good or service they are selling, the obligation of providing such professional services may become increasingly burdensome and costly as a result of the COVID-19 crisis (e.g. due to labor shortages).
- ▶ **Variable Consideration:** Under ASC 606 (Revenue from Contracts with Customers), if companies have contracts that contain variable consideration (for example, contracts with discounts, refunds, or penalties), the variable consideration initially estimated at contract inception may need to be reassessed and recalculated. For example, if companies need to provide refunds or discounts on a previously promised good or service that cannot be provided timely due to the COVID-19 crisis, prior estimates of the variable consideration will need to be revised. The revised estimate must then be updated at each reporting date throughout the contract term. Accordingly, the related disclosures (e.g., methods, inputs, and assumptions) of the revised estimate of variable consideration must also be updated.
- ▶ **Material Right:** Companies may decide to offer their customers significant discounts (or other price concessions) in upcoming/ future renewal periods in order to provide their customers some relief from the COVID-19 crisis. When offering such discounts, companies must assess whether their amended customer contracts now include a material right, which would be accounted as a separate performance obligation (typically over the customer relationship period).
- ▶ **Customer Collectability:** As a result of the COVID-19 crisis, some customers may encounter financial difficulties and become incapable of making timely payments for the remaining promised goods or services purchased under a contract. Even if customer collectability was deemed probable at contract inception, a significant change in facts and circumstances would require the Company to reassess the probability of collectability to determine if the contract remains under the scope of ASC 606.

Asset Impairment

- ▶ **Impairment Indicators:** Some examples of impairment indicators that may arise (and trigger consideration of an impairment test) from the COVID-19 crisis are as follows:
 - **Indefinite-lived intangible asset:** (a) decline in financial performance (e.g. cash flow issues, decline in actuals compared to projected) or (b) change in market for a Company's products or services due to declining industry conditions.
 - **Long-lived asset/asset group:** (a) significant decrease in the market price, (b) accumulation of costs significantly in excess of the amount originally expected for acquisition/construction, (c) current expectation that, more likely than not (probability of more than 50%), a long-lived asset will be sold/disposed of significantly before the end of its previously estimated useful life.
 - **Goodwill:** (a) decline in stock price/market capitalization and (b) indicators listed above for indefinite-lived intangible asset are also applicable.
- ▶ **Order of Impairment Testing:** If Companies determine that there are impairment indicator(s) to consider, they must perform impairment tests in the following order:
 1. Indefinite-lived intangible assets (in accordance with ASC 350 -30 (Intangibles — Goodwill and Other)),
 2. Long-lived asset / asset group (in accordance with ASC 360-10 (Impairment and Disposal of Long-Lived Assets), and
 3. Goodwill (in accordance with ASC 350-20 (Intangibles — Goodwill and Other)).
- ▶ **Equity Method Investments:** Companies should review their investments for impairment if the carrying amount of their investment(s) may not be recoverable as a result of the COVID-19 crisis (in accordance with ASC 323, Investments — Equity Method and Joint Ventures).
 - Some examples of impairment indicators of investments are as follows: (a) inability of the investee to sustain earnings, (b) current fair value of investment is less than the carrying amount and (c) other investors ceasing to provide support or reduce their financial commitment to the investee.

Compliance with Debt Covenants

Many Companies are facing temporary closures to help contain the spread of COVID-19. This will likely result in disruptions of normal business operations, lost revenue, reduced collections of customers 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.

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, we believe 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. Companies are encouraged to consult with their advisers in these situations.

As Companies work with lenders to address these potential issues, terms of debt arrangements may be modified to address covenant violations, or changes to payment terms to alleviate cash flow burdens in the near-term. Companies will 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. Companies should consider the guidance in ASC 470-50 (Debt — Modifications and Extinguishments) and ASC 470-60 (Debt — Troubled Debt Restructurings by Debtors) to properly classify and account for the amended debt agreements.

FINANCIAL REPORTING CONSIDERATIONS

Temporary Filing Relief from the SEC

Pursuant to Section 36 of the Exchange Act, the SEC issued an Order on March 4, 2020 for registrants affected by the COVID-19 crisis to allow an additional 45 days for registrants to file Exchange Act reports (e.g., Forms 10-K, 10-Q, and 20-F) scheduled to be due between March 1, 2020 and April 30, 2020. Registrants obtaining this filing relief must file a Form 8-K (or Form 6-K for foreign private issuers) by the later of March 16, 2020 or the original filing deadline of the report that includes the following: (a) a statement that it is relying on the Order, (b) a brief description of reasons why it could not file timely, (c) the estimated date by which filing is expected, (d) if appropriate, a risk factor explaining, if material, the impact of COVID-19 on its business, and (e) if the reason the report cannot be filed timely relates to any person, other than the registrant, to furnish a required opinion, report, or certification, the Form 8-K (or Form 6-K) shall have an attached statement signed by such person to state the specific reasons on or before the filing deadline.

Risk Factors and MD&A

On Form 10-Q and Form 10-K, registrants should update the disclosures related to Risk Factors (in Item 1A) that may affect future results as a result of the COVID-19 crisis. Similarly, disclosures in the MD&A section should be updated if financial results were adversely impacted.

Going Concern

- ▶ In accordance with ASC 205-40 (Presentation of Financial Statements — Going Concern), in preparing financial statements for each annual and interim reporting period, management must evaluate whether there are conditions and events (e.g. COVID-19 crisis) that raise substantial doubt about an entity's ability to continue as a going concern within one year after the date the financial statements are issued or available to be issued (when applicable).
 - Some examples of conditions that may raise substantial doubt about an entity's ability to continue as a going concern are as follows: (a) negative financial trends (e.g., operating losses, working capital deficiencies, negative cash flows from operating activities), (b) other indications of possible financial difficulties (e.g., a need to restructure debt to avoid default, a need to seek new sources or methods of financing, or a need to dispose of substantial assets), (c) internal matters (e.g., work stoppages or other labor difficulties), (d) external matters (e.g., loss of a principal customer or supplier).
- ▶ If, after considering management's plans, substantial doubt about the Company's ability to continue as a going concern is alleviated as a result of consideration of management's plans, the Company should disclose all of the following: (a) principal conditions or events that raise the substantial doubt, (b) management's evaluation of the significance of those conditions or events relative to the Company's ability to meet its obligations, and (c) management's plans that are intended to mitigate the conditions or events that raise the substantial doubt.

Subsequent Events

- ▶ **Recognized subsequent events:** In accordance with ASC 855 (Subsequent Events), companies affected by the COVID-19 crisis may need to update and adjust their financial statements (including estimates utilized in the preparation of the financial statements) to accurately present all known facts that existed as of the balance sheet date before the financial statements are issued.
- ▶ **Non-Recognized subsequent events:** If events or transactions related to the COVID-19 crisis occur subsequent to the balance-sheet date but prior to the issuance date of the financial statements, companies may need to update disclosures for subsequent events. Although an adjustment of the financial statements would not be required, subsequent event disclosures may need to be updated to prevent the financial statements from being misleading. The disclosures would include the nature of the event and an estimate on the impact on the financial statements (or an assertion that such an estimate cannot be made).

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. In addition, significant measures taken by the Chinese government and by private sector organizations did not take place until early 2020.

However, 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 31, 2020 which prompted national governments began 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.

Based on the timing of these events, for calendar year-end companies the effects of the coronavirus represent a subsequent event that is not expected to impact amounts recognized in the year-end financial statements (i.e., a non-recognized subsequent event). Accordingly, forecasts, projections, and associated assumptions used in preparing financial statements as of December 31, 2019, would reflect either little or no change solely as a result of the coronavirus outbreak. However, debt classification may be impacted, as discussed above.

TAKEAWAYS

The persistence of COVID-19 and its extraordinary toll on daily life, both personally and from a business perspective, will undoubtedly introduce challenges to individuals and the overall business community. The situation remains fluid and companies should continue to stay abreast of developments impacting their operations and accounting and reporting obligations.

CONTACT

MICHAEL STEVENSON

Accounting & Reporting Advisory Services
National Practice Leader and Partner
214-665-0707 / mstevenson@bdo.com

ROB BRIGHT

Accounting & Reporting Advisory Services
Partner
610-455-2066 / rbright@bdo.com

FAISAL JEDDY

Accounting & Reporting Advisory Services
West Region Practice Leader and Partner
408-352-3603 / fjeddy@bdo.com

ROB TRINCHETTO

Accounting & Reporting Advisory Services
Northeast Region Practice Leader and Partner
631-927-1171 / rtrinchetto@bdo.com

BDO is the brand name for BDO USA, LLP, a U.S. professional services firm providing assurance, tax, and advisory services to a wide range of publicly traded and privately held companies. For more than 100 years, BDO has provided quality service through the active involvement of experienced and committed professionals. The firm serves clients through more than 65 offices and over 700 independent alliance firm locations nationwide. As an independent Member Firm of BDO International Limited, BDO serves multi-national clients through a global network of more than 88,000 people working out of more than 1,800 offices across 167 countries and territories.

BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. BDO is the brand name for the BDO network and for each of the BDO Member Firms. For more information please visit: www.bdo.com.

Material discussed is meant to provide general information and should not be acted on without professional advice tailored to your needs.

© 2020 BDO USA, LLP. All rights reserved.