

ASPE Alert

ACCOUNTING STANDARDS FOR PRIVATE ENTERPRISES

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Assessing COVID-19 Effects on Financial Statements: Subsequent events and other considerations

COVID-19 and related government measures are having significant impacts on the Canadian and global economy. Health and safety considerations are driving many of the impacts on businesses, including supply chain disruptions, the need for shutdowns and cost containment measures. There is significant uncertainty around the long-term economic and business consequences.

This CPA Canada Alert (Alert) discusses whether companies applying Accounting Standards for Private Enterprises (ASPE) in Part II of the *CPA Canada Handbook - Accounting (Handbook)* should adjust annual financial statements issued in 2020 for the effects of COVID-19. The accounting treatment will depend on whether the financial statements cover a period that has been affected by COVID-19 or whether COVID-19 is a subsequent event.

Fair Presentation

The key principles for fair presentation are provided in Section 1400, *General Standards of Financial Statement Presentation*. Section 1400 specifies the following three requirements:

- (a) applying GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section 1100;
- (b) providing sufficient information about transactions or events having an effect on the entity's financial position, results of operations and cash flows for the periods presented that are of such size, nature and incidence that their disclosure is necessary to understand that effect; and
- (c) providing information in a manner that is clear and understandable.

COVID-19 is unique in the nature and scale of its impacts. These impacts, the understanding of them and the resulting government measures are evolving rapidly, and for many businesses, result in significant uncertainty. In accordance with Section 1400, private enterprises should ensure they (a) apply ASPE correctly to the changing circumstances, (b) ensure disclosures are as complete as possible, including disclosing assumptions, significant judgements and other uncertainties, and (c) do their best to make the financial statements, including the notes, understandable to the reader.

Should December 31, 2019 year-end financial statements be adjusted for the expected effects of COVID-19?

Financial statements should reflect the circumstances at the end of the reporting period and the operating results and cash flows for the period ended on that date. Section 3820, *Subsequent Events*, states that “Financial statements shall not be adjusted for those events occurring between the date of the financial statements and the date of their completion that do not relate to conditions that existed at the date of the financial statements”.

Per 3820.04, there are two types of subsequent events:

- (a) those that provide further evidence of conditions that existed at the financial statement date;
and
- (b) those that are indicative of conditions that arose subsequent to the financial statement date.

The extent to which, and the manner in which, the effect of a subsequent event is reflected in the financial statements will depend on its type.

Although COVID-19 was reported in China before December 31, 2019, there were few reported impacts in Canada at that date, and the World Health Organization (WHO) did not declare a public health emergency until January 2020. For many Canadian companies with December 31, 2019 year-ends, COVID-19 related events and impacts are likely to be non-adjusting events because they do not provide additional evidence relating to conditions existing at the financial statement date.

Should disclosure about expected COVID-19 effects be included in December 31, 2019 year-end financial statements?

Section 3820.10 requires that “Disclosure shall be made of those events occurring between the date of the financial statements and the date of their completion that do not relate to conditions that existed at the date of the financial statements but:

- (a) cause significant changes to assets or liabilities in the subsequent period; or
- (b) will, or may, have a significant effect on the future operations of the enterprise.”

In completing their December 31, 2019 financial statements, companies will need to consider whether post December 31 COVID-19 events meet one (or possibly both) of the above conditions. This will require management judgement, as of the date of completion¹ of the financial statements, on the significance of the effects of COVID-19 on the entity.

Assume Alpha Company is preparing financial statements for the year ended December 31, 2019. The income statement and balance sheet have not been impacted by the effects of COVID-19. However, the scale of COVID-19 at the date of completion of the financial statements and its likely effects on Alpha Company may require subsequent event disclosure. In addition, events such as new government regulation, contract cancellation by a major customer, closure of operations, employee layoffs or other matters related to COVID-19 may have occurred between December 31, 2019 and the date of completion of the financial statements.

If these events meet one of the above conditions, paragraph 11 of Section 3820 requires, at a minimum, disclosure of:

- (a) a description of the nature of the event; and
- (b) an estimate of the financial effect, when practicable, or a statement that such an estimate cannot be made.

Disclosures should, to the extent possible, include expected impacts on the entity. Broad statements on the general economic environment provide limited useful information to users of the financial statements. Where a specific estimate of the impact is not possible, management should consider providing information on the range of potential impacts or a qualitative discussion of the likely impacts on the entity and their significance. Disclosures should be clear and transparent so as to provide the user of the financial statements with as much entity-specific information as possible.

Should financial statements with year-ends subsequent to December 31, 2019 be adjusted for the effects of COVID-19?

By March 2020, COVID-19 had become a major issue in Canada. A company preparing financial statements for the year ended March 31, 2020 will likely need to adjust the income statement and balance sheet as a result of the impacts of COVID-19.

The impacts to be reflected in the March 31, 2020 financial statements would be based on circumstances existing at March 31, 2020 and may include impairment of assets, recording liabilities and other accounting adjustments that result from COVID-19. The COVID-19 situation is evolving quickly, which is likely to create significant uncertainty regarding what the conditions existing at the balance sheet date actually were.

Assume Beta Company is preparing annual financial statements for the year ended March 31, 2020. The income statement and balance sheet will likely need to include the effects of circumstances related to COVID-19 at March 31, 2020. However, additional events related to COVID-19, such as

¹ Completion generally means the approval of the financial statements by the directors or other authorized parties.

new government regulation, may occur between March 31 and the date of completion of the financial statements. If these events meet one of the two subsequent event criteria in Section 3820 (discussed above), Beta Company is also required to reflect the effects of such events in its March 31, 2020 financial statements.

COVID-19 Implications on Going Concern Assessments

Section 1400, *General Standards of Financial Statement Presentation*, states that “Financial statements shall be prepared on a going concern basis unless management either intends to liquidate the entity, or to cease trading, or has no realistic alternative but to do so”. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the balance sheet date. This assessment also includes careful analysis of the impact of events that occur between the year-end and the date of completion of the financial statements. It would consider the uncertainty over the effects and duration of COVID-19 as well as the impact of various government measures.

Material uncertainties over going concern should also be disclosed. Section 1400 states: “When management is aware, in making its assessment of an entity’s ability to continue as a going concern, of material uncertainties related to events or conditions that may cast significant doubt upon the entity’s ability to continue as a going concern, those uncertainties shall be disclosed”.

Determining whether there is significant doubt about the entity’s ability to continue as a going concern is heavily dependent on company-specific circumstances and may require significant judgment. The determination is made based on the best available information, which may be some time after the date of the financial statements. Preparers should work closely with their auditors when making this determination.

Auditor Requirements

The auditor is required to perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor’s report that require adjustment of, or disclosure in, the financial statements have been identified. The date of the auditor’s report informs the reader that the auditor has considered the effect of events and transactions of which the auditor becomes aware and that occurred up to that date.

As part of performing procedures, the auditor considers whether management’s assessment of the entity’s ability to continue as a going concern includes all relevant information of which the auditor is aware as a result of the audit. Recognizing that the implications resulting from COVID-19 will have a significant impact on a large number of businesses, the basis for management’s going concern assessments may require more attention by the auditor in the current environment. New information is coming to light and businesses may be making significant strategic decisions daily. These factors will be critical to informing the auditor’s evaluation of management’s going concern assessment and the related disclosures in the entity’s financial statements.

If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor is to obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern.

If the auditor concludes that a material uncertainty exists, the auditor is required to determine whether the financial statements adequately disclose the events or conditions that may cast significant doubt and management's plans to deal with them, and discloses clearly that there is a material uncertainty. Even though appropriate disclosures about material uncertainty are made in the financial statements, the auditor is required to draw attention to the note in the financial statements which discloses these matters. Drawing attention to a matter through use of such a section in the auditor's report does not modify the auditor's opinion in respect of the matter.

If the auditor concludes that no material uncertainty exists, the auditor is still required to evaluate whether the financial statements provide adequate disclosures about these events or conditions. In these circumstances, the auditor may consider that the disclosures of these events or conditions are fundamental to users' understanding of the financial statements and that it is necessary to draw their attention to such disclosures by including an Emphasis of Matter paragraph in the auditor's report that refers to the disclosures.

If the auditor determines that adequate disclosure of material uncertainty has not been made in the financial statements, the auditor may need to express a qualified or adverse opinion.

Relevant Canadian Auditing Standards (CAS) include:

- CAS 560 *Subsequent Events*
- CAS 570 *Going Concern*
- CAS 700 *Forming an Opinion and Reporting on Financial Statements*
- CAS 705 *Modifications to the Opinion in the Independent Auditor's Report* and
- CAS 706 *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*.

Conclusion

The minimum required disclosures regarding subsequent events and going concern have been identified above. It should be noted that for interim statements issued after December 31, 2019, the same approach for subsequent events and going concern disclosures apply.

Given the broad impact of COVID-19 across many industries and all parts of the world, entities that do not incorporate any COVID-19 effects in their financial statements or include subsequent event notes may consider including a note explaining why.

Resources

[COVID-19 Information Resources](#)

Contact

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