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# Accounting, Disclosure, and Internal Control Considerations Related to Coronavirus Disease 2019

## Background

Global responses to the coronavirus disease 2019 (COVID-19) outbreak continue to rapidly evolve. COVID-19 has already had a significant impact on global financial markets, and it may have accounting, disclosure, and internal control implications for many entities. Some of the key impacts include, but are not limited to:

- Interruptions of production.
- Supply chain disruptions.
- Unavailability of personnel.
- Reductions in sales, earnings, or productivity.
- Disruptions in or stoppages of nonessential business travel.
- The closure of facilities and stores.

In addition, entities should consider the increasingly broad effects of COVID-19 as a result of its negative impact on the global economy and major financial markets.

## Introduction

This *Financial Reporting Alert* discusses certain key accounting, disclosure, and internal control considerations related to conditions that may arise as a result of COVID-19. Although the virus was first detected in Wuhan City, Hubei Province, China,<sup>1</sup> it has had more far-reaching ramifications. This publication is divided into the following sections:

- [Accounting Considerations.](#)
- [Disclosure and SEC Reporting Considerations.](#)
- [Internal Control Considerations.](#)

Entities must carefully consider their unique circumstances and risk exposures when analyzing how recent events may affect their financial reporting. Specifically, financial reporting and related financial statement disclosures need to convey all material current or potential effects of COVID-19. It is also critical that management understand the risks that entities are dealing with and how such risks may affect them. SEC registrants must also consider the need to disclose information in other areas of an SEC filing, such as MD&A or risk factors, in addition to the footnotes to their financial statements. Furthermore, entities may want to be aware of, and discuss with their auditors, problems that could be encountered in completing audits, such as:

- Travel restrictions that do not allow for visits to offices in affected areas to complete essential audit work.
- The inability to prepare or provide information necessary for the audit related to operations in affected areas (e.g., personnel may not have access to the information because of the closure of China offices).

In a [public statement](#) issued on January 30, 2020, SEC Chairman Jay Clayton commented that it “may be difficult to assess or predict [the effects of COVID-19] with meaningful precision”; however, “how issuers plan for that uncertainty and how they choose to respond to events as they unfold can nevertheless be material to an investment decision.” Chairman Clayton also stated that the SEC staff would “to the extent necessary or appropriate, provide guidance and other assistance to issuers and other market participants regarding disclosures related to the current and potential effects of the coronavirus.”

On February 19, 2020, Chairman Clayton — in a [joint public statement](#) with SEC Division of Corporation Finance Director Bill Hinman, SEC Chief Accountant Sagar Teotia, and PCAOB Chairman William D. Duhnke III — updated comments from his January 30, 2020, statement on disclosures related to the current and potential effects of COVID-19. In the February 19, 2020, statement, Chairman Clayton 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.” Chairman Clayton encouraged issuers to engage directly with the SEC staff on questions about those matters.

On March 4, 2020, the SEC followed up on its prior statement by [issuing an order](#) (the “Order”) that gives public companies an additional 45 days to file certain reports that would otherwise have been due between March 1 and April 30, 2020, if specified conditions are met. The Order follows a model that is similar to the existing accommodations under SEC Rule 12b-25.<sup>2</sup> To use the relief allowed by the Order, a registrant must file a current report on Form 8-K (or Form 6-K, as applicable) that discusses, among other things, (1) why the issuer is “unable to meet a filing deadline due to circumstances related to COVID-19,” (2) the estimated date by which the related filing will be made, and (3), if appropriate and material, a risk factor describing the

<sup>1</sup> See the Centers for Disease Control and Prevention’s [Web site](#).

<sup>2</sup> SEC Exchange Act Rule, *Notification of Inability to Timely File All or Any Required Portion of a Form 10-K, 20-F, 11-K, N-CEN, N-CSR, 10-Q, or 10-D*.

impact of COVID-19 on the registrant's business. The SEC will continue to monitor the impact of COVID-19 and may extend the time period for the relief if needed.

The SEC also continued to encourage companies to evaluate their disclosure obligations related to COVID-19 and its potential impact on securities transactions. Because the potential effects of COVID-19 could constitute material nonpublic information, companies should consider how their codes of ethics and insider trading policies address, prevent, and deter trading that is based on material nonpublic information related to COVID-19. If a company becomes aware of a material risk related to COVID-19, it should also consider whether and, if so, when to implement trading restrictions until it has appropriately informed investors. Further, as more information becomes available and risks evolve, a company may need to consider updating previous disclosures.



### **Connecting the Dots**

The SEC's actions reinforce the importance of maintaining audit and financial reporting quality despite emerging issues such as COVID-19. Registrants who are concerned that COVID-19 could negatively affect their financial reporting quality or ability to meet SEC filing deadlines are encouraged to proactively reach out to their auditors, legal counsel, or the SEC, as appropriate, to consider the availability of the relief provided by the Order.

## **Accounting Considerations**

The outbreak of COVID-19 could have a number of potential accounting implications for entities, particularly those with subsidiaries, operations, investments, or joint ventures in areas affected by the virus. Entities with significant suppliers, vendors, or customers in areas affected by the virus, as well as entities that lend to or borrow from entities in areas affected by the virus, also may experience accounting challenges. In addition, we do not expect the potential accounting and reporting implications to be limited only to entities with direct exposure to or presence in areas affected by COVID-19; given the broader global economic impact of COVID-19 on financial markets, we believe that the outbreak will also pose increasing risks and potentially have accounting implications for all entities with exposure to a broader economic downturn and decline in financial markets.

As COVID-19 continues to spread globally, it may be appropriate for entities to consider the impact of the outbreak on accounting conclusions and footnote disclosures related to, but not limited to, the following:

- Asset (including goodwill) impairments.
- Valuation and impairment of receivables, loans, and investments.
- Valuation of defined benefit plan assets and obligations.
- Loss contingencies.
- Stock compensation performance conditions and modifications.
- Contractual penalties.
- Employment termination benefits.
- Going concern.
- Subsequent events.
- Insurance recoveries related to business interruptions.
- Lease rent concessions.

The ultimate recognition of accounting impacts related to these issues will vary depending on each entity's specific facts and circumstances. However, there are certain areas of financial reporting that may be more likely to have a recognized accounting impact as a result of the COVID-19 outbreak:

- *Impairment of goodwill* — Entities may need to assess whether the impact of COVID-19 has led to an asset impairment. Their financial performance, including estimates of future cash flows and earnings, may be significantly affected by the direct or indirect impacts of recent and ongoing events. ASC 350-20-35-30 requires entities to perform an impairment test 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” (sometimes referred to as a triggering event); in such cases, the applicable guidance for measuring and recognizing an impairment loss should be followed.
- *Impairment of long-lived assets* — ASC 360-10-35-21 states that entities may need to evaluate whether a long-lived asset or group of assets must “be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.” When making this assessment, entities should consider the examples in that guidance, including whether there has been a “significant decrease in the market price of a long-lived asset,” a “significant adverse change in the extent or manner in which a long-lived asset . . . is being used or in its physical condition,” or a “significant adverse change in . . . the business climate that could affect the value of a long-lived asset.” As a result of the impacts of COVID-19, certain entities may need to perform an impairment assessment of long-lived assets.
- *Valuation and impairment of receivables, loans, and investments* — Given the current downturn in financial markets in many areas, entities should consider the impacts of significant fluctuations in the value of investments and assess them for impairment. Investments that may be affected include equity securities and debt issued by entities that are domiciled in an affected area and, in certain instances, investments in sovereign debt. Moreover, events in an affected area may cause additional volatility in the global markets, which may have an impact on the fair values of investments that are not directly linked to affected areas (e.g., credit spreads may widen or the creditworthiness of counterparties may be affected). An entity's selection of the applicable impairment model, as well as the related considerations for revaluation of receivables, loans, and investments, is based on the instruments' classification under U.S. GAAP (e.g., equity securities without readily determinable fair values, available for sale and held-to-maturity debt securities, investments in equity method investments, and joint ventures). In some cases, the applicable impairment model also depends on whether an entity has adopted [ASU 2016-13](#)<sup>3</sup> related to credit losses.
- *Consideration of subsequent events recognition and disclosure* — At the end of each reporting period, entities should carefully evaluate information that becomes available after the balance sheet date but before the issuance of the financial statements relative to the subsequent events guidance in ASC 855.<sup>4</sup> In particular, for nonrecognized subsequent events, ASC 855-10-50-2 requires entities to disclose both “[t]he nature of the event” and “[a]n estimate of its financial effect, or a statement that such an estimate cannot be made,” if the absence of such disclosures would result in misleading financial statements. The SEC's February 19, 2020, statement further emphasized the importance of considering the sufficiency of subsequent-events disclosures.

<sup>3</sup> FASB Accounting Standards Update (ASU) No. 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*.

<sup>4</sup> For titles of FASB Accounting Standards Codification (ASC) references, see Deloitte's [“Titles of Topics and Subtopics in the FASB Accounting Standards Codification.”](#)

While financial statement disclosures as of December 31, 2019, were primarily related to the potential impact of COVID-19 as a nonrecognized subsequent event, we expect that there may be an increase in the recognition of accounting impacts related to COVID-19 in future filings (e.g., Form 10-Q for the quarter ended March 31, 2020) for matters that become known during the subsequent-events period after the balance-sheet date. Depending on how the ongoing spread of COVID-19 affects the economy and financial markets, management will need to continue to consider subsequent-events-related accounting recognition and disclosure requirements in future reporting periods.

## Disclosure and SEC Reporting Considerations

In a manner similar to the treatment of other current risks (e.g., Brexit, the phaseout of LIBOR, or cybersecurity), entities may need to add disclosures about the impact of COVID-19 in their SEC filings. In recent Form 10K filings for the year ended December 31, 2019, entities most commonly provided such disclosures in one or more of the following areas:

- *Risk Factors* — Registrants must disclose information about the most significant risks that apply to their company or its securities. While many registrants may already disclose a general risk related to issues such as potential natural disasters or pandemics, they should also consider whether there is a need to update the risk factor to clarify that it is no longer just a hypothetical risk and provide more specificity about the potential impact of COVID-19.
- *MD&A* — Registrants should disclose any known trends or uncertainties that have had, or are reasonably expected to have, a material favorable or unfavorable impact on revenues or income. Registrants that are materially affected by COVID-19 should include MD&A disclosures related to the current and potential future impact on their operations, financial condition, or liquidity. Such disclosures could provide (1) early-warning signals to investors that revenue growth or profit margins may not be sustainable because of the impact of COVID-19, (2) information about when and under what conditions impairments or other charges may be incurred in the future, or (3) both.
- *Footnotes to the financial statements* — As discussed earlier, if issues related to COVID-19 materially affect entities' accounts, U.S. GAAP may require them to provide subsequent-events disclosures related to the potential impact of COVID-19 in their financial statements as well as to provide other account-specific disclosures.

While these disclosures would most often be included in a Form 10-K or Form 10-Q, many registrants have also provided disclosures of the potential impact of COVID-19 in a Form 8-K related to their earnings release, specifically with regard to the potential impact on revenue and earnings guidance for future periods.

In determining the nature and extent of the disclosures needed, registrants should consult with legal counsel and consider potential issues such as:

- Store or facility closures.
- Loss of customers or customer traffic.
- The impact on distributors.
- Supply chain interruptions.
- Production delays or limitations.
- The impact on human capital.
- Regulatory changes.
- The risk of loss on significant contracts.

Registrants should also consider providing disclosures about their controls and procedures related to emerging risks. At the 2019 AICPA Conference on Current SEC and PCAOB Developments, Chief of the SEC's Division of Corporation Finance's Office of Trade and Services Mara Ransom emphasized that if companies expect the impacts of evolving risks to be material, they should consider providing disclosures to address:

- How management assesses the risks.
- What management is doing to mitigate and manage the risks.
- The board's role in risk oversight.

## Internal Control Considerations

Because of the impact of COVID-19, entities may need to implement new internal controls or modify existing ones. Any changes in internal controls that have materially affected, or are reasonably likely to materially affect, entities' internal control over financial reporting must be disclosed<sup>5</sup> in Item 4 of Form 10-Q or Item 9A of Form 10-K, of entities' quarterly or annual filings, respectively (or Item 15 of Form 20-F for foreign private issuers).

Entities will need to consider the operating effectiveness of controls, including assessing any breakdown in review-type controls or the inability of individuals to perform control duties because of absences (e.g., due to employee illness or the closure of affected offices). Entities should also consider how a lack of information may affect management's ability to effectively operate controls (e.g., personnel may not be available in offices in China or other affected areas to provide information that is essential to the effective operation of an internal control). If an existing control cannot be performed, management may need to identify alternative appropriately designed controls to compensate for the lack of information.

Entities should also consider management's ability to complete its financial reporting process and prepare its financial statements on a timely basis. Delays in closing the underlying financial records may increase the potential for error in the financial statements and merit the use of new or modified controls to offset the increased risk of potential financial statement error. In addition, entities will need to ensure that they have properly designed and implemented controls related to the selection and application of GAAP for the accounting and disclosure issues arising from COVID-19.

## Ongoing Considerations

Looking ahead, we expect the impact of COVID-19 on the global economy and financial markets to continue evolving. Entities should evaluate the related accounting issues and disclosure considerations discussed above as facts and circumstances change.

<sup>5</sup> See SEC Regulation S-K, Item 308(c).

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