Due to the ongoing effects of the COVID-19 pandemic, 2020 year-end financial reporting may be more challenging than previous years. Multiple, normally infrequent situations may have arisen that require special accounting and reporting considerations. This article contains a summary of existing guidance on common issues that companies might encounter for 2020 financial statements, including impairment of nonfinancial assets, debt concessions, balance sheet classification of debt, and going concern.

**Impairment of Nonfinancial Assets**

There are several models for impairment of nonfinancial assets, as noted in the table below. A company needs to consider whether business disruptions existed or exist and indicate a triggering event has occurred. Certain business disruptions might relate to short-term liquidity concern, while others relate to future expectations about the cash flows of the business, which is ultimately a question of fair value of a business or certain of its assets.

If a triggering event occurred, an impairment assessment is warranted, and assumptions and cash flow forecasts used to test for impairment should be updated to reflect the potential effect of COVID-19. Budgets, forecasts, and other assumptions should reflect the increased risk and uncertainty.

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The guidance highlighted below contains similar concepts, such as forecasts that are based on what was known or reasonably knowable as of the forecast preparation date, but differences and nuances exist for the proper application of generally accepted accounting principles (GAAP) within a company’s financial statements. This summary provides a foundation and general awareness; an analysis of a company’s unique facts and circumstances will determine the relevant GAAP. Companies may need to seek professional assistance to help ensure proper application for this COVID-19 year-end.

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1 Assumes the entity has not elected the goodwill private company alternative (Accounting Standards Update (ASU) 2014-02) and has adopted ASU 2017-04, Simplifying the Test for Goodwill Impairment.

See BKD Thoughtware® article, “Goodwill Impairment Test Simplified.”
The timing of impairment testing is based on the underlying asset as noted in the graphic below:

<table>
<thead>
<tr>
<th>Asset Type</th>
<th>Testing Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goodwill&lt;sup&gt;1&lt;/sup&gt; ASC 350-20</td>
<td>• Test annually</td>
</tr>
<tr>
<td></td>
<td>• Test upon triggering event</td>
</tr>
<tr>
<td>Indefinite-lived intangible assets ASC 350-30</td>
<td>• Test annually</td>
</tr>
<tr>
<td></td>
<td>• Test upon triggering event</td>
</tr>
<tr>
<td>Asset group ASC 360</td>
<td>• Test upon triggering event</td>
</tr>
</tbody>
</table>

### Triggering Events

Events both inside and outside of a company can cause a triggering event. The following, nonexhaustive list provides some events and circumstances to consider in determining whether an interim, *i.e.*, at date other than year-end, goodwill impairment test is necessary:

- Macroeconomic conditions, *e.g.*, deterioration in the general economy
- Industry and market considerations, *e.g.*, deterioration in the environment in which the company operates, a decline in market-dependent multiples or metrics
- Cost factors, *e.g.*, increases in the cost of raw materials, labor
- Overall financial performance, *e.g.*, negative or declining cash flows, a decline in actual or planned revenue or earnings compared with actual and projected results of relevant prior periods
- Other relevant entity-specific events, *e.g.*, changes in management or key personnel
- Events affecting a reporting unit, *e.g.*, change in composition of net assets, expectation of disposing all or a portion of the reporting unit
- A sustained decrease in share price (in either absolute terms or relative to peers)

Current market turmoil related to COVID-19 might cause assets’ carrying values to exceed current fair values. This conclusion would warrant the assessment of impairment or recoverability of assets.

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<sup>1</sup> The private company accounting alternative allows an entity to amortize goodwill over 10 years (or less, if another useful life is more appropriate). ASU 2014-02 created an accounting policy election to test goodwill for impairment at the entity level or the reporting unit level. Under this alternative, impairment testing is required only upon a triggering event (see BKD article, “Private Company Reporting: Accounting for Goodwill”).
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ASC 350 – Goodwill & Other Indefinite-Lived Assets

Step 1 – Qualitative Impairment Test

The qualitative assessment allows companies to first consider events and circumstances that may affect the fair value of an indefinite-lived intangible asset to determine whether it is necessary to perform the quantitative impairment test. This determination must be based on all relevant factors such as macroeconomic developments, political or regulatory changes, the emergence of new industry competitors, managerial or structural changes within the firm, and others. If the preliminary qualitative assessment shows that the goodwill carried on the company’s balance sheet is unlikely to exceed its fair value, then no further testing is required. If the carrying value is too high, quantitative testing is required.

Step 2 – Quantitative Impairment

If the qualitative assessment indicates that it is not more likely than not (a likelihood of 50 percent or more) that goodwill is impaired, further testing is unnecessary. To perform this step, the company compared the carrying value on the balance sheet to the fair value of the reporting unit. If the fair value of the reporting unit is less than the carrying value, the goodwill must be impaired. The goodwill impairment loss is calculated as the difference between the carrying value and fair value of the reporting unit. The impairment loss cannot exceed the entity’s carrying amount of goodwill. Subsequent reversal of a previously recognized impairment loss is prohibited. Disclosure requirements in the event of an impairment loss include description of the facts and circumstances leading to the impairment, the amount of the impairment loss, and the method(s) used for determining fair value of the reporting unit.

On February 10, 2020, FASB approved changes to provide relief on the goodwill triggering to certain private companies and not-for-profits (NFP) only if they report goodwill (or report accounts that would be affected by a goodwill impairment such as retained earnings and net income) on an annual basis. The changes, once finalized, also would allow private companies and NFPs to perform the goodwill impairment triggering event assessment at the reporting date any time that they report financial information, including interim reports (see BKD article, “FASB Reconsiders Goodwill Impairment Triggers – Limited Relief Proposed for Private Companies”).

ASC 360 – Long-Lived Assets Classified as Held & Used

Accounting Standards Codification (ASC) 360 requires that a company recognize an impairment loss if—and only if—the carrying amount of a long-lived asset (asset group) is not recoverable from the sum of the undiscounted cash flows expected to result from the use and eventual disposal of the asset, and if the carrying amount exceeds the asset’s fair value.

Indicators of Impairment

Impairment testing should be completed whenever—not just at year-end—events or changes in circumstances indicate the asset’s carrying value may not be recoverable. Examples of indicators of impairment include but are not limited to:
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- A significant decrease in the market price of a long-lived asset (asset group)
- A significant adverse change in the extent or way a long-lived asset (asset group) is being used or in its physical condition
- A significant adverse change in legal factors or in the business climate that could affect the value of a long-lived asset (asset group), including an adverse action or assessment by a regulator
- An accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of a long-lived asset (asset group)
- A current period operating, or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of a long-lived asset (asset group)
- A current expectation that—more likely than not—a long-lived asset (asset group) will be sold or otherwise disposed of significantly before the end of its previously estimated useful life (the term “more likely than not” refers to a level of likelihood that is more than 50 percent)

Recoverability Test

The recoverability test under ASC 360 differs from the quantitative test under ASC 350. The quantitative test is an impairment test, requiring measurement of the fair value of a reporting unit or an indefinite-lived asset. ASC 360 calls for a recoverability test to be performed to determine if an impairment loss exists, in which case the fair value of an asset or asset group must be determined. The recoverability test is based on the sum of the future undiscounted cash flows expected to be derived from the use and eventual disposition of the asset or asset group. The sum of the future undiscounted cash flows is compared to the carrying value of the asset or asset group at the date of the test. If the future undiscounted cash flows exceed the carrying amount, the carrying value is deemed to be recoverable through the use and eventual disposition of the asset or asset group. If, however, the carrying value exceeds the future undiscounted cash flows, an impairment loss must be measured based on the fair value of the asset or asset group.

Estimates of the future cash flows include only the future cash flows that are expected to arise as a direct result of the long-lived asset (asset group) in question, whether through continuing use or through disposal. These estimates should incorporate management’s assumptions as to the future use of the asset and should be reasonable in relation to the assumptions used in developing other internal prospective financial information, such as budgets and projections. These estimates should cover the remaining useful life of the long-lived asset (asset group). However, if alternative courses of action to recover the carrying amount of a long-lived asset (asset group) are under consideration or if a range is estimated for the amount of possible future cash flows associated with the likely course of action, the likelihood of those possible outcomes should be considered. A probability-weighted approach may be useful in considering the likelihood of those possible outcomes.

Asset Grouping

To perform a long-lived asset impairment analysis, the asset group needs to be determined. An asset group is the grouping of assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. Most long-lived assets do not generate cash flows independent of an entity’s other assets and liabilities. They are usually dependent on other complementary assets to generate cash flows and—because the unit of accounting for the impairment testing of long-lived assets is based on identifiable cash flows generated—the long-lived asset cannot be tested on its own; the long-lived asset and the complementary assets are grouped together for impairment testing.
Goodwill should be included in an asset group to be tested for impairment only if the asset group is or includes a reporting unit. Goodwill should not be included in a lower-level asset group that includes only part of a reporting unit. Estimates of future cash flows used to test that lower-level asset group for recoverability should not be adjusted for the effect of excluding goodwill from the group.

**Determining the Primary Asset of the Group**

Estimates of future cash flows used to test the recoverability of a long-lived asset (asset group) shall be made for the remaining useful life of the asset (asset group) to the entity. The remaining useful life of an asset group shall be based on the remaining useful life of the primary asset of the group. The primary asset is the principal long-lived tangible asset being depreciated or intangible asset being amortized that is the most significant component asset from which the asset group derives its cash-flow-generating capacity. The primary asset of an asset group cannot be land or an intangible asset not being amortized. Factors that an entity generally shall consider in determining whether a long-lived asset is the primary asset of an asset group include the following:

- Whether other assets of the group would have been acquired by the entity without the asset
- The level of investment that would be required to replace the asset
- The remaining useful life of the asset relative to other assets of the group. If the primary asset is not the asset of the group with the longest remaining useful life, estimates of future cash flows for the group shall assume the sale of the group at the end of the remaining useful life of the primary asset

**Measuring the Impairment**

If the recoverability test indicates an impairment, the loss is measured by determining the fair value of the asset or asset group and comparing such fair value to the carrying value. The amount by which the carrying value exceeds the fair value is recorded as an impairment loss. The loss should be allocated to the asset group’s long-lived assets on a pro rata basis using the asset’s relative carrying amounts, except that the loss allocated to an individual long-lived asset of the group should not reduce the carrying amount of that asset below its fair value whenever that fair value is determinable without undue cost and effort. The adjusted carrying amount of a long-lived asset should become its new cost basis. If the long-lived asset is depreciable, the new cost basis should be depreciated/amortized over the asset’s remaining useful life.

*Restoration of a previously recognized impairment loss is not allowed.*

**Fair Value**

Fair value, as defined in ASC 820, is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. For long-lived assets (asset groups) that have uncertainties both in timing and amount, an expected present value technique will often be the appropriate technique with which to estimate fair value. ASC 820 prescribes that the measurement of the fair value of an asset or liability should be based on assumptions that market participants would use when pricing the asset or liability. The long-lived asset impairment testing process relies on a number of key concepts referenced in ASC 820, including unit of account, exit price, valuation premise, highest and best use, principal market, market participant assumptions, and the fair value hierarchy, which form the foundation of the fair value measurement approach.

**Debt**

FASB released an educational paper that reviews a debtor’s application of guidance on debt restructurings and modifications along with several common examples. While the paper is a valuable educational resource, companies should consider the specific facts and circumstances of debt modifications or restructurings to determine the appropriate accounting. The most frequent debt relief includes:
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- Reduction of the stated interest rate for the remaining term of the debt
- Extension of the maturity date (or dates) at a stated interest rate lower than the current market rate for new debt with similar risk
- Reduction of the debt’s face or maturity amount as stated in the debt arrangement or other agreement
- Reduction of accrued, but unpaid, interest

The paper reviews guidance in ASC 470-60, Debt – Troubled Debt Restructuring by Debtors, and ASC 470-50, Debt – Modifications and Extinguishments.

Concessions

Different Cash Flows + Same Lender = Consider Subtopic 470-50 & 470-60

Due to changes in:
- Principal
- Interest Rate
- Maturity Date
- Payment Timing
- Other Items

Legal form of debt not relevant
Includes exchanges of debt with the same lender

10% test for modification or extinguishment accounting (470-50)
Troubled debt restructuring (470-60)

Debt Concessions—Borrower Considerations

<table>
<thead>
<tr>
<th>Troubled Debt Restructuring</th>
<th>Future undiscounted cash payments are:</th>
</tr>
</thead>
<tbody>
<tr>
<td>less than the net carrying value of the original debt</td>
<td>• A gain is recorded for the difference • The carrying value of the debt is adjusted to the future undiscounted cash flow amount • No interest expense is recorded going forward • All future interest payments reduce the carrying value</td>
</tr>
<tr>
<td>greater than the net carrying value of the original debt</td>
<td>• No gain is recorded • A new effective interest rate is established based on the carrying value of the original debt and the revised cash flows</td>
</tr>
<tr>
<td>Continuation</td>
<td>• No gain or loss is recorded • A new effective interest rate is established based on the carrying value of the original debt arrangement and the revised cash flows</td>
</tr>
<tr>
<td>Extinguishment</td>
<td>• A gain or loss is recorded • The old debt is derecognized, and the new debt is recorded at fair value • Interest expense is recorded based on the effective interest rate of the new debt</td>
</tr>
</tbody>
</table>
Balance Sheet Classification of Debt

Covenant Violations

Debt that is contractually due more than one year from the balance sheet date—or operating cycle, if longer—is classified as noncurrent unless a violation that gives the lender the ability to call the debt has occurred at the balance sheet date or would have occurred absent a loan modification. If a waiver is obtained, as of the balance sheet date, debt must be classified as current if it is probable that the same or a more restrictive covenant will not be met within 12 months from the balance sheet date. A covenant violation after the balance sheet date generally does not affect classification at the balance sheet date, but disclosure is required and this would be part of management’s considerations related to going concern (see page 8).

Subjective Acceleration Clauses

A subjective acceleration clause is a provision in debt agreement that permits the creditor to accelerate the debt’s scheduled maturities under conditions that are not objectively determined, i.e., if the debtor fails to maintain satisfactory operations or if a material adverse change occurs. Debt classification is based on the likelihood of the due date being accelerated based on the facts and circumstances that existed at the balance sheet date. Careful consideration should be given when there are liquidity issues.

Lease Concessions

COVID-19 is expected to result in many lease modifications and concessions. Guidance in ASC 840 and 842 includes analysis to determine whether a modification results in a new lease or a continuation of the existing lease on a contract-by-contract basis. This includes reviewing whether enforceable rights and obligations are created or are consistent with the original contract terms. This guidance was intended for routine, negotiated modifications and did not contemplate the size, scale, and temporary nature of COVID-19 changes. On April 10, 2020, FASB released a set of four frequently asked questions that address lease concessions.

- Entities may elect to account for COVID-19-related concessions as if enforceable right and obligation for those concessions existed in the original contract (eliminating a need to review contracts)
- If elected, entities would not have to apply the modification accounting guidance in ASC 840 or 842
- Elections are only for concessions that do not result in a substantial increase in the lessor’s rights or lessee obligations
As a result of COVID-19 and its associated effects, entities need to consider whether, in their specific circumstances, they have the ability to continue as a going concern for more than one year after the date on which the interim or annual financial statements are issued (or available to be issued, when applicable). The initial assessment (before consideration of management’s plans) will require an entity to consider, among other things:

- Extent of operational disruption
- Potential diminished demand for products or services
- Contractual obligations due or anticipated within one year
- Potential liquidity and working capital shortfall
- Access to existing sources of capital, i.e., available line of credit

An entity can only base this initial assessment on information that is available, i.e., known and reasonably knowable, as of the issuance date of the financial statements. An entity may be able to alleviate substantial doubt, if it exists, if it is probable that its plans will be effectively implemented, and, when implemented, will mitigate the conditions that are raising substantial doubt in the first instance and will do so within one year after the issuance date of the financial statements. Further, an entity must provide comprehensive disclosures in its annual and interim financial statements when events and conditions are identified that raise substantial doubt about the entity’s ability to continue as a going concern even when management’s plans alleviate such doubt.

If substantial doubt is not raised, make required disclosure under ASC 275, Risks and Uncertainties, and ASC 450, Contingencies.

For further details, see BKD article, “Management’s Going Concern Reminder.”
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Fair Value Measurements

Existing guidance in ASC 820, *Fair Value Measurement*, addresses the current market disruptions caused by COVID-19, including:

- Measuring an asset’s fair value when volumes and/or activity levels have significantly decreased
- Identifying transactions that are not orderly

Income Tax Accounting & Deferred Tax Asset Valuation Allowances

For taxable entities, accounting for income taxes in an environment with changing tax laws and operational and other challenges will require revisiting Topic 740 to ensure proper application to new circumstances, including the need for valuation allowances in some cases.

Keeping up with changes in tax laws is a full-time job, so consider visiting our website to stay current with tax-related Thoughtware.

Hedging

Topic 815 provides guidance on when to discontinue cash flow hedge accounting and when and how to reclassify amounts deferred in accumulated other comprehensive income. On April 28, 2020, FASB released a Q&A addressing how the postponement or cancellation of forecasted transactions related to the effects of the COVID-19 pandemic should be considered when applying cash flow hedge accounting in accordance with Topic 815.

- COVID-19 delays in forecasted transactions may be considered rare cases caused by extenuating circumstances outside an entity’s control or influence
- A COVID-19-related missed forecast would not call into question an entity’s ability to accurately predict forecasted transactions and future use of cash flow hedge accounting

Fraud Risk

COVID-19 may create additional pressures or opportunities to commit fraud. Management should consider whether changes in controls to prevent or detect fraud are needed. Management should understand the characteristics of each control and how it operates currently. With many employees working remotely, information may not be available, and the ability to retain evidence may be affected.

If the company does not have a hotline, consider how BKD fraud professionals can assist.

Conclusion

There are many other areas of GAAP that might require a fresh look this COVID-19 year-end as companies respond to this dynamic environment in new ways. If you have questions about year-end reporting, contact your BKD Trusted Advisor.

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