

Potential impact of the COVID-19 pandemic on financial reporting by private enterprises and on assurance

For years ended before March 1, 2020

The Order and its working groups are currently examining matters relating to the current and potential impact of the pandemic on the presentation, audit and review of financial statements prepared in accordance with accounting standards for private enterprises (ASPE).

The questions and answers below provide an overview of certain requirements and considerations. They do not cover all topics or matters underlying those topics, nor do they address the ongoing evolution of the pandemic or the particular circumstances facing any one enterprise. Please exercise caution and refer to the original, up-to-date documents before making a decision.

The answers provided generally apply to private enterprises operating in Canada for **years ended before March 1, 2020**, but would also apply to not-for-profit organizations. Implications for years ending on or after March 31, 2020 will be addressed in a separate communication.

1. Is the COVID-19 crisis considered a subsequent event?

Yes. Given the current situation, it is reasonable to conclude that, for most enterprises, implications will largely result from the public health measures ordered by governments beginning on March 13, 2020.

2. Is it necessary to adjust the financial statements to consider subsequent events relating to the COVID-19 crisis?

Accounting implications

The financial statements must be adjusted when the event occurring after the financial statement date provides additional information relating to conditions that already existed on the financial statement date.¹ The COVID-19 crisis is instead a condition that arose subsequent to the financial statement date.²

- For example, an enterprise that appropriately estimated the allowance for doubtful account attributable to a significant account receivable as at December 31, 2019 (based on conditions that existed on that date) must not adjust that allowance

¹ Paragraphs .07 and .09 of Section 3820, *Subsequent Events*.

² Paragraph .04 of Section 3820, *Subsequent Events*.

retrospectively to take into account the increased risk of non-collection resulting from the COVID-19 crisis.

- The same principle applies to other assets, such as inventories, advances, investments (whether quoted or not), and long-term assets, such as property, plant and equipment, intangible assets, and goodwill, that decreased significantly in value after the financial statement date due to the COVID-19 crisis.

In the current situation, COVID-19-related implications would not result in adjustments to the financial statements for years ended before March 1, 2020. However, disclosures may be needed in the notes (see Question 3).

3. Should the subsequent events relating to the COVID-19 crisis be disclosed in a note to the financial statements?

3.1. Accounting implications

Disclosure shall be made of those events subsequent to the financial statement date that:

- will cause significant changes to assets or liabilities in the subsequent period; or
- will, or may, have a significant effect on the future operations of the enterprise.³

It is reasonable to conclude that, for most enterprises, the pandemic will result in one or both of the implications described above.

At a minimum, the disclosure must include:

- a description of the nature of the event; and
- an estimate of the financial effect, when practicable, or a statement that such an estimate cannot be made.⁴

These disclosure requirements constitute minimum requirements. Professional judgment must be exercised to ensure the disclosures are consistent with achieving the objective of fair presentation.⁵

In the context of the COVID-19 crisis, there are two possible scenarios.

Scenario 1: *The enterprise believes that the COVID-19 crisis will cause significant changes to assets or liabilities or will, or may, have a significant effect on its future operations.*

The enterprise must include a note in the financial statements describing the subsequent events and provide an estimate of the financial effect or a statement that such an estimate cannot be made.

³ Paragraph .10 of Section 3820, *Subsequent Events*.

⁴ Paragraph .11 of Section 3820, *Subsequent Events*.

⁵ Paragraphs .03 to .06 of Section 1400, *General Standards of Financial Statement Presentation*, and of Section 1401, *General Standards of Financial Statement Presentation for Not-for-Profit Organizations*.

If the anticipated effects are extensive — such as actual or potential temporary closures, mass layoffs, or major supply problems — providing an estimate of the financial effect will be more difficult, but not necessarily impossible.

Scenario 2: *The enterprise concludes that the COVID-19 crisis will not cause significant changes to assets or liabilities and will not, or may not, have a significant effect on its future operations.*

In this scenario, there would be no need to include a note on subsequent events. Given the current context, this scenario is likely to be uncommon.

3.2. Examples of notes

Below are two examples of notes for Scenario 1. To be in accordance with ASPE, the examples **must be adapted** to the specific situation of each enterprise.

Subsequent events

In March 2020, the World Health Organization declared a global pandemic due to the novel coronavirus (COVID-19). The situation is constantly evolving, and the measures put in place are having multiple impacts on local, provincial, national and global economies.

Management is closely monitoring the situation and already estimates that it will result, among other things, in the loss of at least \$xxx in accounts receivable for which no allowance for doubtful accounts was recorded as at December 31, 2019, and in the total impairment of its investment in a private entity accounted for at a cost of \$xxx as at December 31, 2019. The company has also temporarily closed its Sherbrooke and Montreal plants since March 20, 2020, temporarily laid off over 30 employees at its headquarters since March 23, 2020, and anticipates short-term supply problems for raw materials and increased purchase prices.

The overall effect of these events on the company and its operations is too uncertain to be estimated at this time. The impacts will be accounted for when they are known and may be assessed.

Note:

Information in italics will be disclosed if the enterprise is able to provide an estimate of this kind of financial effect. The availability of this type of information may depend on a number of factors, including how much time has passed between the year-end date and the date the financial statements are issued.

Subsequent events

In March 2020, the World Health Organization declared the outbreak of a novel coronavirus (COVID-19) as a global pandemic, which continues to spread in Canada and around the world.

As at xx, 2020, the company is aware of changes in its operations as a result of the COVID-19 crisis, including the closure of its offices *[for an indefinite period or until April 13, 2020 by provincial decree]*.

Management is uncertain of the effects of these changes on its (consolidated) financial statements and believes that any disturbance may be temporary; however, there is uncertainty about the length and potential impact of the disturbance.

As a result, we are unable to estimate the potential impact on the company's operations as at the date of these financial statements.

3.3. Assurance: Should an Emphasis of Matter paragraph or Other Matter paragraph be added to the audit report or review engagement report if the financial statements contain a note regarding this subsequent event?

Audit

Event occurring prior to the date of the auditor's report

If, in accordance with CAS 705, *Modifications to the Opinion in the Independent Auditor's Report*, the auditor is not required to modify the opinion, under paragraph 8 of CAS 706, *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*, the auditor **may consider** it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, **is of such importance that it is fundamental to users' understanding of the financial statements**. If so, the auditor may deem it necessary to include such an Emphasis of Matter paragraph.

The following are illustrations of circumstances, taken from paragraph A5 of CAS 706, in which the **auditor may consider it necessary** to include an Emphasis of Matter paragraph:

- A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report;
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

However, it is also important to consider that the current crisis is an event everyone is aware of and that it will not be necessary to add an Emphasis of Matter paragraph to all reports. Nevertheless, the implications may be significant to the extent that the situation creates material uncertainty related to going concern. The next question addresses such situations.

The effects of the COVID-19 crisis may vary widely from one enterprise to another and professional judgment must be exercised to determine whether the note regarding this subsequent event is fundamental to users' understanding of the financial statements. The practitioner must be sure that adding an Emphasis of Matter paragraph is necessary because overusing this paragraph could reduce its impact.

Example of Emphasis of Matter paragraph:

Emphasis of Matter – Subsequent Events

We draw attention to Note X to the financial statements, which describes subsequent events related to the global COVID-19 pandemic declared by the World Health Organization. Our opinion is not modified in respect of this matter.

Review

Paragraph .95 of CSRE 2400, *Engagements to Review Historical Financial Statements*, contains similar requirements to those of CAS 706. The practitioner may therefore deem it appropriate to include such a paragraph in the review engagement report.

Example of Emphasis of Matter paragraph:

Without modifying our conclusion, we draw attention to Note X to the financial statements, which describes the situation in the context of the COVID-19 global pandemic declared by the World Health Organization.

4. To what extent is the current situation creating material uncertainty related to going concern?

4.1. Accounting implications

It is reasonable to assume that the COVID-19 crisis may have implications on issues related to going concern.

The effects of the current crisis may be so pervasive that the viability of the whole or a part of the enterprise is brought into question. A rapid deterioration in operating results or financial position after the date of the financial statements may indicate a need to consider whether it is proper to continue to use the going concern assumption.⁶ (See paragraphs .07 and .08 of Section 1400, *General Standards of Financial Statement Presentation*, or of Section 1401, *General Standards of Financial Statement Presentation for Not-for-Profit Organizations*).

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 (financial statement date).

⁶ Paragraph .05 of Section 3820, *Subsequent Events*.

Assessing the validity of this assumption will involve professional judgment, taking into account the enterprise's specific situation, the evolution of the pandemic, announcements about government financial assistance programs, and relief measures from financial institutions.

When the anticipated effects are significant enough to bring the viability of all or a part of the enterprise into question, two scenarios may arise:

Scenario 1: After the balance sheet date, the entity determines that a material uncertainty now exists that may cast significant doubt on the enterprise's ability to continue as a going concern due to the COVID-19 crisis.

It will, in many cases, be appropriate to base the financial statements on the going concern assumption. However, there may be material uncertainties related to events or conditions that may cast significant doubt on the enterprise's ability to continue as a going concern. Paragraph .17 of Section 1400 requires disclosure of these material uncertainties. In this scenario, a note must be included in the financial statements indicating the material uncertainties that may cast significant doubt on the enterprise's ability to continue as a going concern due to the COVID-19 crisis.

Scenario 2: After the balance sheet date, the entity determines that it intends to liquidate the entity or to cease its operations, or that it has no realistic alternative but to do so, due to the COVID-19 crisis.

When the going concern assumption is no longer appropriate for preparing the financial statements due to an event that occurred subsequent to year-end, even if the situation did not exist at the financial statement date (e.g. December 31, 2019), the financial statements must not be prepared on a going concern basis. They must be **adjusted as at the financial statement date** to reflect this fact, for example, by preparing the financial statements as at December 31, 2019 on a realizable value basis (or any other basis deemed appropriate).

4.2. Example of a note

Below is an example of a note disclosing the existence of material uncertainty that may cast significant doubt on the enterprise's ability to continue as a going concern due to the COVID-19 crisis. To be in accordance with ASPE, this example **must be adapted** to the specific situation of each enterprise.

Going Concern Assumption

These financial statements were prepared using accounting standards that apply to an operating enterprise. This assumes that the enterprise will continue its operations for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of operations.

In March 2020, the World Health Organization declared a global pandemic due to COVID-19. Following this event, the Company was forced to suspend its operations, which led it to be in breach of the covenants on its current borrowings. There is significant doubt as to the Company's ability to continue operating.

The Company is fairly confident to qualify for some of the assistance programs that have been announced and believes that it can secure amendments to the covenants and to the terms of its current bank borrowings. At this time, the Company is attempting to secure various options from its lenders to amend the terms of its credit facilities. The Company has not yet received government assistance or reached an agreement with its lenders, and there is no guarantee that it will do so or that its efforts to secure financing will be successful. The continuation of the Company's activities depends on the resumption of its operations within a reasonable time and on its ability to obtain credit facilities, restructure its financing agreements, and restore, and then maintain, its profitability.

These financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. This is because management believes that the aforementioned measures it has taken or intends to take will mitigate the effect of the conditions and events that cast doubt on the appropriateness of this assumption.

4.3. Assurance: What are the implications of the COVID-19 crisis on the work required with regards to the going concern assumption in assurance engagements?

The current situation is affecting a large share of global economic activity.

Therefore, in this context, it is presumed that a more detailed analysis of the validity of the going concern assumption must be performed and documented for all assurance engagements.

4.4. Assurance: What are the implications of material uncertainties related to going concern for the auditor's report or review engagement report?

Scenario 1: Use of the going concern basis of accounting is appropriate but a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern.

Audit

When the financial statements contain a note stating that a material uncertainty exists that may cast significant doubt on the going concern assumption, and the auditor feels that the information presented in the financial statements is appropriate, paragraph 22 of CAS 570, *Going Concern*, requires that the report:

- (a) Express an unmodified opinion; and
- (b) Include a separate section under the heading "Material Uncertainty Related to Going Concern" (unless otherwise set out by law or regulation) to:

- (i) Draw attention to the note in the financial statements or other historical financial information describing the material uncertainty;
- (ii) State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

Illustration 1 of Chapter 11 of the *Reporting Implications of the Canadian Auditing Standards (CAS)* guide presents this type of scenario.

Review

Paragraph .99 of CSRE 2400 contains similar requirements. It also requires that an Emphasis of Matter paragraph be added to the review engagement report.

Example of Emphasis of Matter paragraph:

Emphasis of Matter – Material Uncertainty Related to Going Concern

Without modifying our conclusion, we draw attention to Note X to the financial statements, which discloses that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern.

Scenario 2: Adequate disclosure of a material uncertainty that may cast significant doubt is not made in the financial statements.

Audit

For this scenario, paragraph .23 of CAS 570 requires that the auditor express a qualified opinion or an adverse opinion.

Illustrations 2 and 3 of Chapter 11 of the *Reporting Implications of the Canadian Auditing Standards (CAS)* guide present scenarios with reports containing a qualified opinion and an adverse opinion, respectively.

Review

While the CSRE requirements are not as specific as those in CAS 570 for this situation, practitioners would still deem the situation to be non-compliant with the ASPE framework and must modify their conclusion. Practitioners would use their judgment to determine whether to express a qualified conclusion or an adverse conclusion, and may refer to Illustrations 3 and 4 in CSRE 2400 for guidance.

Scenario 3: Use of going concern basis of accounting is inappropriate.

Audit

If the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the financial statements is inappropriate, the auditor must express an adverse opinion in the report, in accordance with paragraph .21 of CAS 570.

The auditor may refer to Illustration 3 in chapter 11 of the *Reporting Implications of the Canadian Auditing Standards (CAS)* guide for guidance.

Review

While CSRE requirements are not as precise as those in CAS 570 for this situation, practitioners would still deem the situation to be non-compliant with the ASPE framework and must modify their conclusion. Practitioners would use their judgment to determine whether to present a qualified conclusion or an adverse conclusion, and may refer to Illustrations 3 and 4 of review engagement reports in CSRE 2400 for guidance.

5. Have documents been issued to help practitioners apply ASPE in the context of the COVID-19 crisis?

There are several documents prepared in accordance with International Financial Reporting Standards (IFRS) that may be useful. You can find some of them here:

<https://www.cpacanada.ca/en/business-and-accounting-resources/financial-and-non-financial-reporting/mdanda-and-other-financial-reporting/publications/covid-19-external-auditing-reporting-resources>.

The Professional Practice, Assurance and Financial Accounting team
ORDRE DES COMPTABLES PROFESSIONNELS AGRÉÉS DU QUÉBEC

With the collaboration of the Technical working group on ASPE – Financial accounting – Part II