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| Financial Reporting Implications of Covid-19 |
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# Introduction

It goes without saying that the Coronavirus is currently wreaking havoc on the world economy, and it follows that there are some reporting implications to this nightmare that we are all going through that we believe need to be taken into consideration.

“Coronavirus is having a strong impact on the world economy. What about the financial system? Is a systemic financial crisis likely, perhaps along the lines of the crisis 12 years ago in 2008, or even the Great Depression of the 1930s?

There are certainly similarities: widespread bankruptcies, liquidity shortages, large losses and some financial institutions may fail.” *World Economic Forum*

The business and economic threats from the coronavirus outbreak continue. Travel bans have been imposed on millions of people and many countries have placed quarantine measures on their entire populations. Businesses are dealing with lost revenue and disrupted supply chains and there has been significant volatility in financial markets. All the aforementioned have been projected to cause a global recession that may last several years.

Preparers of financial statements will need to take into consideration financial reporting standards that may be significantly impacted. Consideration of the following standards will be important for prepares in order to ensure that they achieve fair presentation and inform users of financial statements.

# IAS 1

In preparing financial statements, management is required to perform an assessment of the going concern of the entity. IAS 10 states that the financial statements should not be prepared on a going concern basis where events after the reporting date indicate that the going concern assumption is no longer appropriate. This calls for entities to assess whether the spreading of Corona virus has any repercussions on their going concern status. Considering the continuous spread of corona virus some revenue lines are affected as customers postpone consumption of some products/services. In making going concern assumptions entities should take into consideration any bailout packages that central governments have communicated to entities. For example, entities in the aviation industry have been some of the hardest hit in the world and going concern may be an issue for a number of them.

# IAS 2 Considerations

Inventory is required to be measured at the lower of Cost and net realisable value and the following need to be considered in determining cost and net realisable value:

## Determining Cost

The cost of inventories should comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

The costs of conversion include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods.

The allocation of fixed production overheads to the costs of conversion is based on the normal capacity of the production facilities. Taking this into account any abnormal costs (costs that would not have been occurred had it not been for the coronavirus outbreak) incurred as a result of downtime as a result of government instituted measures to mitigate the effects of Covid-19 should not be capitalised to inventory however, should be expensed in the period in which they are incurred as these do not represent costs under normal production.

## Determining NRV

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. Businesses will need to estimate selling prices as these might have changed significantly as a result of lack of demand or increase in demand. For example, medical face masks have increased in selling prices significantly as a result of the high demand while prices for basic food staffs in the coming months may decrease as a result of a lack in demand and buying power (i.e. prices had shot up as people were hording groceries in response to the pandemic amid fears of shortages in the future and some companies may retrench or reduce employee salaries due to slow growth.

# IAS 10 Considerations

A common question being asked by preparers of financial statements is whether the Coronavirus pandemic qualifies as an adjusting event in the 31 December 2019 yearend financial statements? In our view, the development and spread of this virus happened in 2020 for markets outside China and does not provide evidence of a condition that existed at 31 December 2019 and therefore is a non-adjusting event. At 31 December 2019 there were no reported cases and little evidence, if any, that the virus would spread amongst humans in Zimbabwe.

Therefore, the impact of balances should be largely unaffected until quarter one of 2020. Entities need to ensure the measurement of their assets and liabilities at 31 December 2019 is not impacted by subsequent development of the virus.

However, coming into January 2020 the spread of the virus became evident that it was spreading beyond the shores of China and as such for entities, with financial year ends starting from the 31st of January 2020 and beyond, should treat the Covid-19 pandemic as an adjusting event.

Therefore, the impact of balances should be affected for financial statements with year ends starting from the 31st of January and beyond. Entities need to ensure the measurement of their assets and liabilities at 31 January 2019 are impacted by subsequent development of the virus.

## Disclosure

If the impact of the Covid-19 is a non-adjusting event (i.e. entities with a year-end of 31 December) but material to the financial statements, it should be disclosed by preparers of financial statements. This disclosure should include a description of the events surrounding Covid-19 and an estimate of the financial effect, or if it is not possible to estimate this, a statement to that effect.

# IAS 12 Considerations

Before recognising Deferred tax on an assessed loss all Zimbabwean entities need to assess whether it is probable that the entity will have sufficient taxable profits in the future to reverse the deferred tax asset. That said, given the implications of Covid-19 future profits may be doubtful due to the projected economic downturn and as such an assessment will need to be made.

# IFRS 13 Considerations

Fair value measurement is a market-based measurement, not an entity-specific measurement. Therefore, entities need to determine fair values based on the current market. As a result, on Covid-19 we are likely to see large fluctuations in market prices and these need to be assessed. Multiple industries have been affected some for the better and some for the worse and fair value estimates need to be considered for reporting purposes.

# IAS 20 Considerations

In response to the looming global crisis multiple governments have decided to provide bailout packages to affected industries and companies. Government grants are defined as assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.

Therefore, entities need to assess whether assistance provided by the government constitute government grants in terms of IAS 20 and if so need to account for such assistance in terms of IAS 20.

# IAS 21 Considerations

In response to Covid-19 The reserve bank of Zimbabwe has issued a pronouncement allowing entities and individuals to transact using free funds (i.e. utilize funds in their Nostro account) which had been prohibited in 2019. This may reopen a can of worms that preparers of financial statements thought they had passed in 2019.

Depending on the period of the pronouncement there may be need to reopen the functional currency issue again and entities from this point forth need to constantly be assessing their functional currency in order to ensure that they comply with IAS 21.

# IAS 37 Considerations

## Onerous Contracts

An onerous contract is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. Many entities in the Zimbabwean economy are now in a precarious position where they have contracts that they have to fulfil however due to the lockdowns and travel bans; this may prove to be costly to satisfy beyond the amount expected to be recovered from their customers in such a case these may be Onerous contracts and will need to be identified through an assessment of current contracts. Given that people are now working from home an example of an onerous contract is when a lessee is still obligated to make payments under the terms of a lease but is no longer using the asset. The amount of the remaining lease payments, less any offsetting sublease income, is considered the amount of the obligation to be recognized as a loss.

## Provisions and Contingent Liabilities

As a result of the Covid-19 pandemic some entities may be unable to deliver on contracted obligations (e.g. if the entity requires inputs from a foreign country under lockdown) and will be required to pay a penalty fee, in such a case depending on the circumstances entities may have to recognise and disclose provisions or disclose a contingent liability.

In addition, other companies may consider restructuring, reduction in size or closure which may lead to provisions that are related to retrenchments and any possible employee related obligations.

# IAS 19 Considerations

It is anticipated that a lot of people are going to lose their jobs as a result of the global economic situation that is anticipated to arise as a result of the Covid-19 pandemic. Therefore, entities will need to take into account termination benefits that that are likely to be given to employees in compensation and accounted for accordingly.

# IAS 36 Considerations

At the end of each reporting period, companies are required to assess whether there is any indicator for the impairment for nonfinancial assets. An asset is impaired when a company is not able to recover it’s carrying value, either through use or selling it. That said given the challenges we are currently facing from the corona virus, Revenue decreasing for some business components, this serves as an impairment indicator and impairment tests need to be performed by management. For example airlines revenue maybe grossly affected for the coming year which affects their profitability and impairment of assets e.g. planes.

# IFRS 9 Considerations

IFRS 9 sets out a framework for determining the amount of expected credit loss that should be recognised. It requires that lifetime ECL’s be recognised when there is a significant increase in credit risk. That said, the pandemic poses an increase in credit risk to multiple issuers of credit e.g. some debtors are going to be retrenched in the coming months placing their ability to service loans at great risk.

Therefore, entities need to assess whether the Covid-19 pandemic represents a significant increase in credit risk and if so need to perform lifetime ECL’s.

# IFRS 16 Considerations:

In response to Covid-19 some lessors have decided to give their lessees payment holidays and/or an increase to the lease term to cover the period that the specified asset is not being used during lockdown which may result in the new payment terms requiring the lessee to perform a reassessment. Depending on the new terms of the lease, the lessee determining the remeasurement may need to determine a revised discount rate based on current market conditions.

# IFRS 15 Considerations

A contract modification includes a change in price of a contract that is approved by the parties to the contract. In response to Covid-19 some entities may renegotiate contract terms with customers in such a cash if the price is adjusted this would serve as a contract modification.

Some entities may provide customers with payment holidays in which case the contracts will result in a significant financing component in with case the transaction price will need to be assessed.

For contracts that include a variable component entities should make sure that they only recognise that portion of the consideration that they expect to be entitled in exchange for fulfilling their obligations specified in the contract. This may need to be reassessed given that customers may be unable to pay variable considerations as they will be in financial distress as a result of the Covid-19 pandemic. Revenue is recognised in these circumstances only when it is probable that the customer will pay the transaction price when it is due net of any price concession.

# Profile:



Desmond T Makoni is an Associate Advisor at Training and Advisory Services. He is an expert in International Financial Reporting Standards (IFRS) and International Public Sector Accounting Standards (IPSAS). He holds a Bachelor of Commerce in Accounting degree and a post graduate Certificate in Theory of Accounting (CTA) and Initial Test of Competence (ITC) with ICAZ. He has considerable experience in both advisory and trainings in Financial reporting.