The Implications of SARS CoV-2 (COVID-19) on the Financial Reporting as at 31 December 2019 – Our View

The SARS CoV-2 (COVID-19) outbreak is having a significant impact on global markets driven by supply chain and production disruptions, workforce restrictions, travel restrictions, reduced consumer spending and sentiment, amongst other factors, which are negatively impacting companies' financial performance. The financial reporting impacts of the outbreak will depend on facts and circumstances, including the degree to which an entity's operations are exposed to the impacts of the outbreak. In the following paragraphs, we briefly highlight some of the financial reporting matters that are expected to be topical for entities with a 31 December 2019 financial year-end.

Subsequent events

The overarching question is whether the novel coronavirus outbreak represents an 'adjusting' or 'non-adjusting' event after the reporting date, as defined by IAS 10 *Events after the Reporting Period*.

The World Health Organization did not announce the coronavirus as a global health emergency until the end of January 2020, and no significant measures were taken by governments until early 2020. Further, the effects of the SARS CoV-2 (COVID-19) outbreak did not have a significant impact on global markets and share prices until February 2020. Therefore, based on the information about the outbreak that was reasonably available as at 31 December 2019, it is likely that market participants would either have made no adjustments to their assumptions, or only inconsequential changes, based on their assessments of the available information and associated risks as at that date. We therefore believe the disruption represents a change in economic conditions that arose after the year end date. That is, it is a non-adjusting subsequent event.

When the impacts of the outbreak are considered non-adjusting events, entities still need to consider whether it is appropriate to make disclosures in their financial statements to reflect new events or changes in conditions after the reporting date, including an estimate of their financial effect, if that can be determined (IAS 10.21). Examples may include estimated effects on impairments of financial and non-financial assets (considering events and new information arising after the reporting date), covenant breaches, amendments, or waivers in lending agreements, losses due to supply chain issues, volatility in commodities or foreign currency exchange markets etc. after 31 December 2019. There is not much detailed guidance on how to provide such disclosures. It is, however, important they are clear, and entities need to be careful to avoid providing disclosures in ways that could be accidentally misleading.

In subsequent interim reporting for calendar year-end entities, or for entities with annual reporting date after 31 December 2019, the accounting impact of the outbreak will need to be recognized, if material. As part of the overall analysis of the financial reporting impacts of SARS CoV-2 (COVID-19), companies may need to evaluate the recoverability of goodwill, intangible assets, property, plant and equipment, and lease right-of-use (ROU) assets.

Going concern

The going concern assumption is a fundamental principle in the preparation of financial statements. Pursuant to the requirements of IAS 10.15, in the wake of the events that occurred after the reporting date to respond to the outbreak, managements are expected to update their going concern assessment to consider all relevant information available up to the date the financial statements are authorized for issue.

In addition, IAS 1 *Presentation of Financial Statements* (par. 26) requires the entity to take all available information about the future into account when preparing its going concern assessment. For example, management's assessment may need to include:

- Updating forecasts and sensitivities as considered appropriate, taking into account risk factors identified and different possible outcomes
- A review of projected covenant compliance in different scenarios
- Expanded disclosures.

In making the assessment, management needs to assess whether these events or conditions, individually or collectively, cast significant doubt on the entity's ability to continue as a going concern, or in severe cases, whether the going concern assumption is still appropriate as a basis for the preparation of the entity's financial statements. If the conclusion is that the consequences of the outbreak have led to a deterioration in operating results and/or financial position after the reporting date that is so severe that the going concern basis of preparation is no longer considered appropriate, the financial statements as at 31 December 2019 would need to be adjusted.

To the extent that events and conditions are identified that may cast significant doubt on an entity's ability to continue as a going concern, disclosure would be required if these events constitute material uncertainties or management's conclusion involved significant judgement (i.e. a 'close call' scenario).

Impairment of non-financial assets and expected credit losses

Assumptions used in impairment calculations for financial and non-financial assets need to reflect reasonable and supportable information available as at 31 December 2019.

In addition, caution should be exercised to avoid inappropriately using hindsight or developing valuation inputs that are not consistent with the conditions or reasonable expectations as at that reporting date. On the other hand, entities should ensure that they properly distinguish SARS CoV-2 (COVID-19) related conditions from other possible triggers that could represent the culmination of conditions that existed over a relatively long period of time, in which case they may be adjusting subsequent events.

In the context of IFRS 9 *Financial Instruments*, expected credit losses (ECLs) represent a measurement of loss based on a probability-weighted amount in combination with forward-looking information. Hence it anticipates credit losses that are not linked to particular loss events that occurred up to the reporting date. The timeline of the outbreak suggests that until the reporting date of 31 December 2019 very little was known about the virus, and the expectation of the impact of the virus infections would have been far less pessimistic than the picture that emerged during January 2020. Therefore, when avoiding undue hindsight, the outbreak would practically not have had an impact even for a probability-weighted estimate.

The above said, for 'Stage 3' exposures, consideration should be paid to guidance in IAS 10, which includes the bankruptcy of a customer after the reporting date as an example of an adjusting event that "usually confirms" that the financial asset was credit-impaired at the reporting date. In light of the outbreak, entities may view such customer bankruptcies after the reporting date not as the usual cases confirming that the obligor was in troublesome conditions already at the reporting date, but instead a non-adjusting event. However, the outbreak should not be viewed as a 'free pass' to regard all bankruptcies after 31 December 2019 as 'non-adjusting' solely on the grounds that the outbreak had not yet had a significant economic impact by then. In a typical bankruptcy, the event of 'going bankrupt' is the culmination of a severe deterioration of the entity's economic substance that leads to insolvency. This is a development that typically takes at least months, if not longer, as the entity normally takes measures to attempt avoiding insolvency.

Evolving information

Potential global and economic impacts of the coronavirus continue to evolve rapidly, and companies should monitor the situation. Companies are encouraged to maintain close communications with their board of directors, external auditors, legal counsel and other service providers as the circumstances progress.

Contact

Tomasz Książek
CEE DPP
Partner
E: tksiazek@kpmg.pl

Mirosław Matusik
CEE DPP
Partner
E: mmatusik@kpmg.pl

Materiał na podstawie broszury KPMG International pt.: „Understanding the implications of COVID-19 (Coronavirus) for private companies".
Skład KPMG CEE.