Covid-19 – financial reporting impacts for 31 December 2019 year-ends (and earlier)

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The events and conditions surrounding the Covid-19 pandemic are creating levels of uncertainty and risk that entities may not have encountered before. Given the global healthcare crisis, various measures are being implemented which include lockdowns, temporary closure of businesses, travel restrictions and various other measures.

The economic impact of these events include:

- Disruption to business operations in general;
- Significant disruption to businesses in 'highly exposed sectors' globally and locally, in particular, trade and transportation, travel and tourism, hospitality/entertainment/sport (including gambling), mining, manufacturing, construction and non-essential retail and healthcare; and
- A significant increase in economic uncertainty, evidenced by more volatile asset prices and currency exchange rates, and a significant decline in long-term interest rates in developed economies.

In addition to the above, oil prices have significantly declined due to the failure of OPEC and Russia to agree to additional production cuts at their March 2020 meeting.

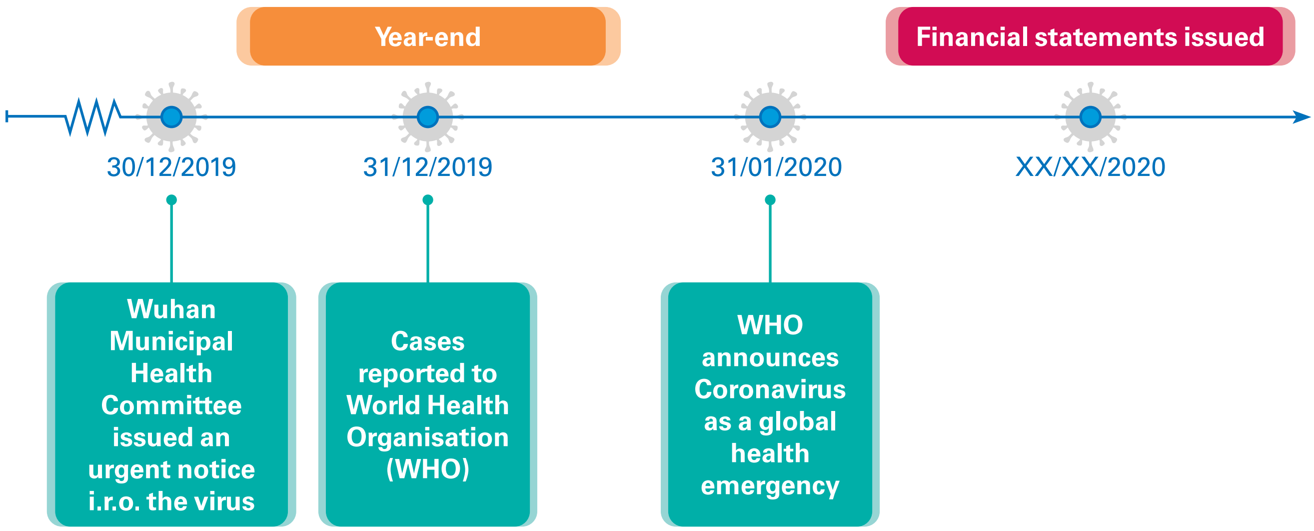
Many entities are being forced to take mitigating action. The current environment gives rise to significant uncertainty for all entities.

Given the above economic impacts, there are specific financial reporting implications for the financial statements of entities for the year ended 31 December 2019 and earlier, where these financial statements have not yet been issued. The specific financial reporting implications will depend on the particular entity and the degree to which its operations are impacted by the outbreak.

Events after the reporting period

Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period (year-end) and the date when the financial statements are authorised for issue.

These events can either be adjusting or non-adjusting events, depending on whether the event(s) provide(s) evidence of conditions that existed at year-end or not. If an event is indicative of conditions that only arose after year-end, the event will be treated as a non-adjusting event.



While certain events occurred prior to 31 December 2019, many of the measures and resulting actions were only taken by national governments and entities in the private sector following the WHO announcement on 31 January 2020.

As a result, based on information that was available at 31 December (or earlier year-ends), the financial reporting effects are generally considered to be non-adjusting events after the balance sheet date. The only exception to this is the consideration of going concern (see below).

Assumptions used in impairment calculations for financial and non-financial assets at the reporting date need to reflect reasonable and supportable information available at that date (for example 31 December 2019). Care should be taken to avoid inappropriate use of hindsight or developing valuation inputs that are inconsistent with conditions or reasonable expectations as at year-end. If the assumptions made in determining the recoverable amount, expected credit losses or other carrying values at the reporting date are aligned to those that a market participant would make at that date, any changes in market conditions subsequent to year-end are non-adjusting events (IAS 10.8-11).

Where the events / conditions are considered to be non-adjusting events, this would not impact the amounts recognised at year-end – no adjustments are made. To the extent that these non-adjusting events are material, entities would need to provide appropriate, entity-specific disclosure. This disclosure should:

- reflect the nature of the events or changes in conditions after the reporting date,
- include an estimate of their financial effect, if that can be determined,
- where an estimate cannot be made, a statement to that effect should be included (IAS 10.21). Where an estimate cannot be made, we would expect an entity to provide qualitative disclosure.

For example, non-adjusting events could include 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 and other events after 31 December 2019.

In contrast, for subsequent interim or annual reporting periods ending after 31 December 2019, the accounting impacts that arise from events and conditions that occur during these reporting periods must be recognised. For further guidance on specific issues that may arise for 2020 year-ends, please refer to KPMG's Covid-19 financial reporting resource centre.

Going Concern

Entities prepare financial statements on a going concern basis unless management either intends to liquidate the entity or cease trading, or has no realistic alternative but to do so.

The assessment as to whether the going concern basis is appropriate takes into account events and conditions after year-end to the date that the financial statements are authorised for issue. As there have been significant new events and changes in conditions since 31 December 2019, for entities with a year-end on or before 31 December 2019, the impacts of these events and conditions should be reflected in the going concern assessment.

Although some sectors and jurisdictions may be more affected than others, all entities across all jurisdictions need to consider the potential implications for the going concern assessment.

Management should perform an assessment of whether these events or conditions, either individually or collectively, cast significant doubt on the entity's ability to continue as a going concern or, in certain severe cases, whether the going concern assumption is still appropriate as a basis for the preparation of the entity's financial statements. Management would need to update any previous going concern assessment that was performed before recent events/conditions.

To the extent that the going concern assumption is not considered appropriate, this is always considered to be an adjusting post balance sheet event and the financial statements are adjusted accordingly.

Where the going concern basis of accounting is still considered to be appropriate, entities should disclose material uncertainties related to events or conditions that may cast significant doubt on their ability to continue as a going concern together with management's plans to deal with these events or conditions. In addition, disclosure is required when management concludes that there are no material uncertainties but reaching that conclusion involved significant judgement (a 'close call').

Given the extent of uncertainty of the impact of the current events and conditions related to the outbreak, we believe that it is likely that most entities would provide some disclosure related to the impact on going concern.

For further guidance on going concern considerations, factors to consider and related financial considerations, please refer to our guidance in this regard (What are the relevant going concern considerations).

Audit implications

The events and conditions arising from the Covid-19 outbreak are likely to have an impact on your audit. There may be changes in audit approach to ensure that we obtain sufficient and appropriate audit evidence. In addition, there is likely to be additional audit work performed in relation to additional disclosure (for events after the balance sheet date) and the going concern assessment.

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