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THE IMPACT OF THE CORONAVIRUS (Covid-19) ON FINANCIAL REPORTING FOR THE YEARS ENDED ON AND AFTER 31 DECEMBER 2019

INTRODUCTION

The emergence of Corona Virus (Covid-19) towards the end 2019 in Wuhan China has resulted in far reaching implications on a global scale. This has had a disruptive effect on economies and the way of living for many and for both rich and poor nations alike.

The Institute of Chartered Accountants in Malawi (ICAM) therefore seeks to advise its members regarding the impact of the Covid-19 Pandemic on its members who report according to International Financial Reporting Standards (IFRS) (or IFRS reporters).

Background

Covid-19 is reported to have started in mid-December 2019 and subsequently announced on 7 January 2020.

Confirmed cases worldwide continue to rise as countries outside China start registering new Covid-19 cases and deaths. This exposes many African countries to the pandemic particularly due to constrained capacity to control it.

Malawi had registered its first ever 4 Covid-19 cases as at 6 April 2020 thus followed the path of its neighbours Zambia, Mozambique, Zimbabwe and Tanzania who also have confirmed cases of Covid-19.

According to the World Health Organisation (WHO) there are 9,310 confirmed cases, 906 recoveries and 444 deaths in Africa alone (as at 6 April 2020) while globally, there are 1,133,758 active cases and 62,784 deaths (as at 5 April 2020). There is currently no vaccine for Coronavirus.

Meanwhile, governments around the world have taken a number of measures to prevent the spread of the Coronavirus and these include advising citizens to observe personal hygiene and avoid handshakes, wash hands with soap and apply hand sanitisers, keep a social distance, a ban of public gatherings of over 100 people, advising travellers to self-quarantine if they travelled to a country known to be high risk and banning international travel. Some countries have gone in a lockdown of operations and advised their citizens to stay at home.

Global and regional impact

The global markets have slumped due to the Covid-19 pandemic amid investor fears that the spread of the virus will destroy economic growth and government action may not be enough to stop the spread.

In response to this impact, Governments and central banks in many countries have taken various mitigating measures, such as reduction of interest rates in order to make borrowing cheaper and to encourage spending to boost economies, as seen in the United Kingdom, and approving economic stimulus packages, as seen in the United States of America where by the US Senate passed a $2 trillion (£1.7tn) coronavirus aid bill to help workers and businesses.

In Malawi, the Central Bank has announced a K12 bn stimulus package to commercial banks; and in its Monetary Policy Committee meeting held on 1st April 2020 reduced its Liquidity Reserve Requirement (LRR) on domestic currency deposits by 125 basis points to 3.75% and reduced the Lombard Rate by 50% to 0.2 percentage points above the policy rate in order to increase liquidity and increase the supply of affordable credit to their customers. Furthermore, the Malawi Government has indicated that it requires a budget of MK16bn to fight the pandemic. So far, Malawi Government has however provided MK2bn.

Businesses in some sectors have already been significantly affected, such as travel and hospitality, and those operating in, or dependent on, supplies from the countries that were first affected by the spread of the virus. As the virus spreads worldwide, it is difficult to predict what its continued impact will be as schools have since been closed, businesses are operating in a lockdown mode while public events have been cancelled or suspended. In addition, flights have been suspended and non-essential travel has been restricted.

Employees in most countries and also in Malawi are working from home and consumers are stockpiling food. Everyone is generally in a panicking mode. According to the Organisation for Economic Cooperation and Development (OECD), the world's economy could grow at its slowest rate since 2009 this year due to the Coronavirus outbreak and there are fears that growth could stagnate.

Locally and regionally, some countries who are key trading partners of Malawi such, as South Africa, are also on a countrywide lockdown.

Financial reporting considerations

The financial reporting considerations of Covid-19 apply to reporting periods ended on and after end 31 December 2019. This guideline also applies to those with reporting period before 31 December 2019 and are yet to sign off on their financial and audit reporting.

This requires considering guidance in IAS 10: Events after the reporting period. IFRS reporters need to assess whether the effects of the Pandemic was representative of factors existing at the reporting date or not. This results in determining whether this pandemic and its various effects is an adjusting or non-adjusting event.

IAS 10 defines an adjusting event as one which 'provides evidence of conditions that existed at the end of the reporting period', while non-adjusting events are those that are indicative of conditions that arose after the reporting period.

The Institute has carefully assessed the impact of the Coronavirus and has concluded that it is a non-adjusting event because there was a limited number of Covid-19 cases in 2019 that were subsequently announced in early January 2020.

Other general reporting considerations that generally affect periods after announcement of the pandemic are discussed below:

- ***IAS 2 Inventories*** – Inventories may need to be written-down to net realizable values due to reduced movement in inventory, lower commodity prices, or inventory obsolescence due to lower than expected sales.

  IAS 2 also requires that fixed production overheads, based on normal production capacity, be included in the cost of inventory. Reduced production, however, might affect the extent to which overheads can be included in the cost of inventory.

Therefore, entities should assess the significance of any write-downs and whether they require disclosure in accordance with IAS 2.

- **IFRS 9 Financial instruments** - Impairment - financial instruments that are in the scope of IFRS 9's expected credit loss model (ECL) should be assessed for impairment in the wake of Covid-19. Particularly the impact of Covid-19 on the ECL.

  Financial instruments that need to be considered include loans, trade and other receivables, debt instruments measured at amortised cost, contract assets, lease receivables, financial guarantees and loan commitments. Generally it is expected that ECLs will increase due to reduced earning capacity arising from staff layoffs or general business slow down.

- **IAS 12 Income taxes** – The pandemic could directly or indirectly affect future profitability of companies due to its impact on customers, suppliers and service providers.

  Entities with deferred tax assets should re-examine their estimates of forecast profits in light of additional uncertainty arising from the pandemic, and the steps taken to control it. This will in turn affect assumptions around the availability of future profits against which tax losses can be utilised and therefore the extent of recoverability of deferred tax assets. This is not only in light of the reasonability of assumptions but also the potential expiry of tax losses (in Malawi tax losses expire after 6 years according to tax law).

- **IFRS 15 - Revenue from contracts with customers** requires that variable consideration is recognised only when it is highly probable that amounts recognised will not be reversed when the uncertainty is resolved.

  Entities should reconsider both its estimate of variable consideration and whether the recognition threshold is met. IFRS 15 is applied only to those contracts where management expects its customer to meet its obligations as they fall due.

  Entities may choose to continue supplying goods and services with full knowledge that customers might not pay for some or all the goods being supplied. 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. IFRS 15 requires that an entity disclose information that allows users to understand the nature, amount, timing and uncertainty of cash flows arising from revenue. This is information such as how an entity has applied its policies taking into account the uncertainty that arises from the pandemic, the significant judgments applied, such as whether a customer is able to pay, and the significant estimates made, in connection with variable consideration.

- **IAS 16 – Property plant and equipment (IAS 16)** - The pandemic may result in some items of property, plant and equipment being under-utilized or not utilised at all for a period, or that capital projects are altogether suspended.

  IAS 16 requires depreciation to still be charged in the statement of profit or loss and other comprehensive income while an asset is temporarily idle. Lower productivity may also indicate that assets are impaired

- **IAS 23 Borrowing costs** requires that the capitalization of interest is suspended when development of an asset is suspended.

- **IAS 37 - Provisions, contingent liabilities and contingent assets**, requires a provision to be recognised only where an entity has a present obligation; it is probable that an outflow of resources is required to settle the obligation; and a reliable estimate can be made.

  An entity's actions in relation to the pandemic should be accounted for as a provision only to the extent that there is a present obligation for which the outflow of economic benefits is probable and can be reliably estimated. For example, a provision for restructuring should be recognised only when there is a detailed formal plan for the restructuring and management has raised a valid expectation in those affected that the plan will be implemented. IAS 37 does not permit provisions for future operating costs or future business recovery.

- **IAS 1 Presentation of financial statements** – Entities should consider the requirements in IAS 1 to disclose the major sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the financial statements in a subsequent period. One such area is going concern as explained below.

- **Going concern -** Entities should consider the potential implications of Covid-19 and the measures taken to control it when assessing the entity's ability to continue as a going concern. An entity is no longer a going concern if management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.

  Entities should consider the impact of measures taken by governments and local banks in its assessment of going concern. Entities should also remember that events after the reporting date that indicate an entity is no longer a going concern are always adjusting events as are events after the reporting date which lead to significant doubt as to whether the company can continue to operate. If, as a result of the virus outbreak, it is assessed that the company can no longer be considered to be a "going concern", this will have a monetary impact on the 2019 financial statements since assets and liabilities in such a case have to be recognised at realisation or breakup values.

  In case of significant uncertainty regarding continued operations, but not such a degree of uncertainty that it is considered necessary to file accounts at realisation values, this must be mentioned in the statement of directors' and management responsibilities and in the notes as is always the case when there is uncertainty regarding continued operations. Material uncertainties that might cast significant doubt upon an entity's ability to continue as a going concern should be disclosed in accordance with IAS 1.

EXTERNAL AUDITORS

The considerations above will remain as key areas of concern during the annual audit process. The failure of auditors to understand these risks increases the risk of the auditor giving a wrong opinion as a result of not performing adequate procedures. The following are key considerations

- **The risk that the entity may not be a going concern**
  Auditors should consider the business impact of Covid-19 that is applicable to the entity taking into account the nature of industry, operational and financial considerations.

- **The need for additional disclosures**
  Additional financial statements disclosure relevant to Covid-19 are required in line with IAS 10 regarding whether this has been assessed as either an adjusting or non-adjusting event.

- **Additional procedures**
  Specific audit procedures now need to be designed in relation to subsequent events such as obtaining a more robust understanding of management's assumptions regarding the impact of Covid-19 on their business.

- **Whether there is, or may be, an impact on the audit opinion**

  Auditors must satisfy themselves whether or not subsequent events regarding Covid-19 are adjusting or non-adjusting.

  Auditors must also assess the risk that entities are not a going concern and the adequacy of related disclosures. They need to determine if they agree with management's going concern assessment that the entity is indeed a going concern, that the assumptions, strategies and forecasts used are reasonable and that adequate disclosures have been made in the financial statements.

  Audit reporting considerations must be made in accordance with International Standard on Auditing (ISA) 570 (Revised), Going Concern, as read in conjunction with ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing.

CONCLUSION

Due to the contagion effect of Covid-19, both healthwise, economically, socially and financially, the Covid-19 pandemic has far reaching ramifications. As a result, IFRS reporters must have a thorough understanding of the implications of Covid-19 on various aspects of their businesses in addition to wider economic considerations.

Various adjustments may be required to fully comply with IFRS. Auditors will equally need to understand and challenge management assumptions regarding the assessment of going concern in view of Covid-19 impact on the business of auditees as is the need for more diligent audit procedures and assessing their conclusion on the adequacy of management disclosures for purposes of a properly informed audit reporting process.

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