



Financial Reporting Guidance under COVID-19

The impact of COVID-19 on people and businesses is unprecedented and uncertain. Global financial markets and the traditional operating models of our clients are under significant stress. This document has been developed to provide guidance on the accounting and financial reporting issues and considerations entities must consider as we move forward in 2020.

The key impacts include, but are not limited to:

Key Impacts of COVID-19
Production halts/interruptions
Unavailability of personnel
Closure of facilities and stores
Inability to raise financing
Level Four travel restrictions
Supply chain disruptions
Reductions in sales, earnings, or productivity
Delays in planned business expansions
Volatility in value of financial instruments
Closure of sports, cultural and leisure activities

Each entity must carefully consider the unique circumstances and risk exposures they are experiencing when analysing how the recent events will affect their financial reporting. Specifically, financial reporting and related financial statement disclosures need to convey all material effects of COVID-19.

The impact of COVID-19 on financial reporting is unprecedented. It will impact all entities and impact multiple elements of financial statements. Understanding the impact is crucial to ensure financial reports, including disclosures, are reliable and meaningful.

Accounting considerations

Entities should consider the impact of accounting conclusions and disclosures related to, but not limited to:

Key Accounting Considerations
Impairment of non-financial assets (including goodwill)
Valuation of inventories
Allowance for expected credit losses
Fair value measurements
Onerous contracts provisions
Restructuring plans
Breach of loan covenants (classification of liabilities as current vs non-current)
Going concern
Liquidity risk management
Events after the end of the reporting period
Hedging relationships
Insurance recoveries related to business interruptions
Employment termination benefits
Share-based compensation performance conditions and modifications
Contingent consideration in contractual arrangements
Modifications of contractual arrangements
Tax considerations (recoverability of deferred tax assets)

The impacts will vary depending on each entity's specific facts and circumstances.

The following sections and accounting areas are likely to be most significantly affected because of COVID-19.

Material judgements and uncertainties

Users of financial reports will expect financial statements to provide appropriate insights into the risks and uncertainties facing the business, along with disclosure of the judgements made in the preparation of financial information.

Each of the areas discussed may be a source of material judgements and uncertainties that requires disclosure. Where this is the case, the entity should provide disclosures, distinguishing between:

- Significant judgements i.e. judgements other than estimations made in applying an entity's accounting policies, often in how an item is characterised; and
- Significant sources of estimation uncertainty i.e. assumptions or other sources of estimation uncertainty (including judgement involving estimation), primarily over the value of an item.

Impairment of non-financial assets (including goodwill)

It is important entities consider how they are going to assess whether the impact of COVID-19 has led to potential asset impairments. The financial performance, including estimates of future cash flows and earnings, will be significantly affected by the direct or indirect impacts of ongoing events.

AASB 136 / NZ IAS 36 *Impairment of Assets* requires impairment testing (i.e. estimate the recoverable amount of the affected cash generating unit)

at the end of each reporting period when there is any indication that the cash generating unit may be impaired. Indicators of impairment include but are not limited to significant changes with an adverse effect on the entity that have taken place during the period, or will take place in the near future in the:

- Market or economic environment in which the entity operates; and
- Extent to which, or the way an asset is used or is expected to be used, such as an asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs or plans to dispose of an asset before the previously expected date.

The far-reaching impacts of COVID-19 will require most entities to undertake impairment assessment of assets. This is in addition to the requirement to perform an impairment test at least annually of goodwill and intangible assets with an indefinite useful life.

Valuation of inventories

Inventories are measured at the lower of their cost and Net Realisable Value (NRV). The impact of COVID-19 on the entity's business and performance may necessitate additional consideration of the NRV calculation and further analysis at the reporting date.

Changes to operations such as production schedules, shutdowns or changes to product mix may trigger the need to review inventory costings and overhead allocations.

Allowance for expected credit losses (ECL)

Most entities will experience cash flow volatility that can impact their ability to meet their obligations under loan arrangements. Economic commentators are predicting the likelihood that the economy will contract and experience negative growth in many sectors which may increase the probability of default for some borrowers. The loss given default rates may also increase due to the fall in value of collateralised assets.

Entities should ensure they have calculated ECL in a way that reflects:

- An unbiased and probability-weighted amount by evaluating a range of outcomes;
- The time value of money; and
- Data that is available at the reporting date about past events, current conditions and forecasts of future economic conditions.

ECL applies to trade receivables, loans, debt securities, as well as the losses recognised in measuring loan commitments and financial guarantee contracts.

The amount and timing of the expected credit losses as well as the probability assigned thereto must be based on reasonable and supportable information that is available without undue cost and effort at the end of the reporting period without the use of hindsight. In some cases, this may require significant judgement.

Fair value measurements

Fair value measurements such as those involved in measuring certain financial instruments and investment properties, should reflect market participant views and market data at the measurement date under current market conditions.

Entities will need to consider fair value measurements based on unobservable inputs (sometimes referred to as level three measurements) and ensure the unobservable input used reflects how market participants would reflect the effect of COVID-19, if any, in their expectations of future cash flows related to the asset or liability at the reporting date.

Onerous contracts provisions

An onerous contract arises when the unavoidable costs of meeting the obligations under the contract exceed the benefits expected to be received. Examples of contracts for which an onerous contract provision may be required include:

- Revenue contracts containing penalties for late or non-delivery;
- Increased costs of fulfilling a customer contract due to the replacement of staff who are infected, subject to quarantine or are otherwise restricted from travel; or having to purchase alternative raw materials at a higher price; and
- Contracts for delivery of services in the education or tourism sectors which oblige entities to provide services to smaller groups than is economically viable.

Restructuring plans

Entities may face difficulties financing or refinancing their operations and be required to restructure, sell or close parts of a business or downsize operations. Entities may be looking to or considering the recognition of restructuring provisions.

Taking up restructuring provisions will require consideration of the appropriateness of the provision, whereby:

- The entity must have a detailed formal plan for the restructuring and raise a valid expectation for those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it. If both criteria are met a restructuring provision should be recognised; and
- Any part of the business is available for immediate sale in its present condition and completion of such a sale within one year is highly probable. If so, the assets and liabilities to be disposed of are classified as held for sale and written down to their fair value less costs to sell if this is lower than their carrying amount.

Breach of covenants

Trading and cash flow volatility may increase the risk of breaching debt covenants. Consideration should be given as to how the breach of a loan covenant would affect the timing of repayment of the related loan and other liabilities (e.g. it becomes repayable on demand), and how it affects the classification of the related liabilities at the reporting date.

If a breach occurs on or before the end of the reporting date and the breach provides the lender with the right to demand repayment within 12 months of the reporting date, the liability should be classified as current in the financial statements in the absence of any agreements made prior to the reporting date that gives a right to defer payment beyond 12 months after the reporting date.

In contrast, a breach of loan covenants after the reporting date is a non-adjusting event that should be disclosed in the financial statements if the information is material. A breach after the reporting date could also affect the entity's ability to continue as a going concern.

Going concern

Financial statements are prepared on a going concern basis unless management intends either to liquidate the entity or to cease trading or has no realistic alternative but to do so.

The assessment as to whether the going concern basis is appropriate considers events after the end of the reporting period. For example, for 31 December 2019, entities that are severely affected by COVID-19, even though the significant impact on operations occurred after year-end, will need to consider the appropriateness of preparing financial statements on a going concern basis.

When the entity is aware of material uncertainties that cast a significant doubt on their ability to continue as a going concern, they should disclose those material uncertainties in the financial statements.

Liquidity risk management

Disruptions in productivity and reduced sales can have implications on an entity's working capital. Entities may look for ways to manage this risk, including the use of alternative sources of funding, such as later payment to suppliers and arrangements with financial institutions such as supplier finance and reverse factoring, which may permit the entity to draw down on finance in exchange for the financial institution paying the entity's suppliers. Similarly, entities may look to obtain early settlement of their trade receivables via a financial institution buying the receivables at a discounted amount to the invoice amount.

Entities should consider how the use of working capital techniques such as these are reflected in the entity's disclosure of its liquidity risk management as required by AASB 7 / NZ IFRS 7 *Financial Instruments: Disclosures*. Entities should also consider the specific disclosure requirements for transfers of financial assets as required by AASB 7 / NZ IFRS 7 in the case where financial assets are sold to fund working capital needs, and the accounting policies and judgements applied in determining the balance sheet and cash flow statement

presentation of amounts due and paid where supplier finance and reverse factoring arrangements are used.

Events after the end of the reporting period

At the end of the reporting period, the entity and the auditor should carefully evaluate information that becomes available after the reporting date but before the issuance of the financial statements and audit report. The amounts in the financial statements must be adjusted to reflect events that provide evidence of conditions that existed at the end of the reporting period.

Additionally, if non-adjusting events (those that are indicative of conditions that arose after the reporting period) are material, an entity would be expected to disclose the nature of the event and provide an estimate of its financial effect, or a statement that such an estimate cannot be made.

With respect to reporting periods ending on or before 31 December 2019, it is our view the effects on an entity are the result of events that arose after the reporting date (e.g. decisions made in response to COVID-19) that may require disclosure in the financial statements but would not affect the amounts recognised.

The rationale for our position that this is a non-adjusting event as at 31 December, is the development and spread of the virus did not take place until January 2020.

As at 31 December 2019, only certain events and associated actions had taken place such as the Wuhan Municipal Health Committee's issue on 30 December 2019 of an urgent notice in respect to the virus. However, although cases were reported to the World Health Organisation on 31 December 2019, its announcement of coronavirus as a global health emergency was not made until 31 January 2020 (following which national governments acted).

In addition, significant measures taken by the Chinese government and by private sector organisations did not take place until early 2020. On this basis, the effects of the coronavirus were generally a 'non-adjusting event' (AASB 110.10-11 / NZ IAS 10.10-11), and therefore forecasts, projections and associated assumptions used in preparing financial statements as at 31 December 2019 would reflect either little or no change as a result of the coronavirus outbreak.

For subsequent reporting periods, COVID-19 may affect the recognition and measurement of assets and liabilities in the financial statements. For further discussion on accounting and financial reporting issues for 2020 reporting refer to page 10.

Other potential impacts

Other areas that might be affected by COVID-19, but have not been touched on in detail include:

- Derivative and hedging considerations, e.g. hedge accounting requirements in respect of transactions no longer considered highly probable or expected to occur;
- Insurance claims, e.g. whether it is virtually certain that amounts are receivable under business interruption;
- Appropriate recognition of termination benefits resulting from a workforce reduction;
- Probability of meeting performance vesting conditions under share-based payment arrangements and the appropriate accounting for modifications of such arrangements;
- Probability of meeting performance targets in business combination arrangements, rebate arrangements with customers or suppliers, variable consideration and commissions;
- Appropriate accounting for modification of contractual arrangements, e.g. a reduction or deferral of lease payments granted by a lessor to a lessee; and
- Tax considerations, e.g. impact of reduced flow of goods and services on transfer pricing agreements; recoverability of deferred tax assets.



Clients with financial years ending on or before 31 December 2019 will be less impacted than those reporting after that date. However, the going concern assumption in preparing financial statements will be significant for all preparers.

2020 financial reporting

For financial years ending on or after 31 January 2020, the effects of COVID-19 must be incorporated into the preparation of financial statements. The effects of the coronavirus are pervasive, and will impact all industries; Supply chain disruptions and recent Federal, State and New Zealand Government quarantine measures mean every sector will likely experience the following impacts:

- Reduced consumer demand for goods and services due to lost income and/or restrictions on consumers' ability to move freely;
- Lack of investment in capital improvements and construction reducing demand for many goods and services;

- Reduction in market prices for commodities and financial assets, including equity and debt instruments; and
- Disruption to supply chains.

As time elapses and the effects of the virus change and evolve, it may become difficult to distinguish which information and facts and circumstances should be incorporated into measurement as at period end and which should result in potential subsequent event disclosure.

The following are financial reporting considerations.

Impairment of assets and provisions

Relevant Standard	Potential Impact of COVID-19	Key Accounting Considerations
AASB 9 / NZ IFRS 9 <i>Financial Instruments</i>	<ul style="list-style-type: none"> • Increase in expected credit losses. • Modifications to financial assets and liabilities (e.g. concessions to payment terms). • Losses incurred on financial guarantee contracts accounted for under AASB 9 / NZ IFRS 9 to third parties or related parties (e.g. cross guarantees of a related party loan). • Decrease in hedge effectiveness or disqualification from continuance of hedge accounting due to forecasted transactions no longer being highly probable. 	<p>Expected credit losses are likely to increase due to an increase in both the probability of default ('PD') and the loss given default ('LGD') for financial assets.</p> <p>As all financial assets subject to ECL require the PD to be estimated over the next 12 months, the effects of COVID-19 uncertainty may be very significant.</p> <p>Entities may need to modify the terms of loans. These modifications may take the form of reduced interest rates, modification to payment terms and 'grace periods' for covenant violations.</p> <p>Entities should consider the requirements of AASB 9 / NZ IFRS 9 for the modification of assets and liabilities. These modifications will generally give rise to gains for borrowers and losses for lenders.</p>
AASB 136 / NZ IAS 36 <i>Impairment of Assets</i>	<ul style="list-style-type: none"> • Indicators of impairment may exist for assets subject to impairment only when such indicators exist (e.g. property, plant and equipment, right-of-use assets, certain intangibles, etc.). • Value in use calculations may need to be adjusted (e.g. revised cash flows and/or adjusted discount rate). • Fair value less costs of disposal may decrease and active markets for certain types of assets may disappear. 	<p>Cash flows included in either a value-in-use or a fair value less costs of disposal calculation need to consider all available information. Given the disruption to operations, the cash flow forecasts will need to incorporate extremely severe 'down side' forecasts.</p> <p>The effect will vary however the effect of a country 'lockdown' for a period of two to three months with little or no revenue being generated during this time should be considered.</p> <p>Refer also going concern discussions on next page.</p>

Relevant Standard	Potential Impact of COVID-19	Key Accounting Considerations
AASB 102 / NZ IAS 2 <i>Inventories</i>	<ul style="list-style-type: none"> Net realisable values may decrease, resulting in increased impairment. If production is decreased, clients must consider that fixed overheads are allocated based on 'normal capacity'. 	<p>If an entity has stopped production, significantly reduced production or is planning to do so for a period, significant portions of fixed production overheads (e.g. rent, depreciation of assets, some fixed labour, etc.) will need to be expensed rather than capitalised, even if some reduced quantity of inventory continues to be produced.</p>
AASB 128 / NZ IAS 28 <i>Investments in Associates and Joint Ventures</i>	<ul style="list-style-type: none"> Reductions in the carrying value of investments accounted for in accordance with the equity method due to losses incurred. Possible impairment of carrying value of investment. Entities may be required to record liabilities for losses incurred beyond the carrying value of their investment. 	<p>Before applying the equity method, an entity must first recognise expected credit losses in accordance with AASB 9 / NZ IFRS 9 if an investment in an associate or joint venture includes a long-term interest that is subject to ECL (e.g. a loan to the investee).</p> <p>After an investor has recorded its share of income from an associate or joint venture as required by the equity method, the remaining carrying value of the investment is still subject to further impairment requirements.</p> <p>An entity applies AASB 136 / NZ IAS 36 to the remaining carrying value. After the carrying value of an interest in an associate or joint venture is reduced to zero, additional losses and a liability are accounted for if the investor has a legal or constructive obligation to make payments on behalf of the associate or joint venture.</p> <p>The effects of COVID-19 may make this type of arrangement more common.</p>

Relevant Standard	Potential Impact of COVID-19	Key Accounting Considerations
AASB 112 / NZ IAS 12 <i>Income Taxes</i>	<ul style="list-style-type: none"> Deferred tax assets may not meet recoverability requirements and therefore may not meet the recognition criteria in AASB 112 / NZ IAS 12. Tax legislation may be passed or at a stage that is considered 'substantially enacted' that changes the way current and deferred taxes are recognised and measured. 	<p>Entities will need to evaluate the likelihood of being able to recover the value of deductible temporary differences.</p> <p>Given the disruption to operations, forecasts may need to incorporate extremely severe 'down side' forecasts.</p> <p>Tax losses and other deductible temporary differences having no fixed expiry or a very long-term expiry (e.g. 20 years) is not justification for the recognition of associated deferred tax assets.</p>
AASB 137 / NZ IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i>	<ul style="list-style-type: none"> Onerous contracts may exist for contractual or constructive obligations (e.g. revenue contracts, purchase contracts for which no benefit will now be obtained by the client). Insurance recoveries relating to losses incurred due to the outbreak may not meet recognition requirements in a reporting period (i.e. recovery may not be 'virtually certain'). 	<p>AASB 137 / NZ IAS 37 does not permit the recognition of future operating losses as liabilities. Losses arising from onerous contracts may increase as the unavoidable costs may exceed the economic benefits derived from the contract.</p> <p>For example, if an entity is obligated to pay costs for a conference held after the end of the reporting period, but it has cancelled the conference due to COVID-19, the cost of the conference would be recognised as a liability at the time of cancellation as it would be an onerous contract (i.e. unavoidable costs exceed the economic benefits).</p>

Going concern

Entities are responsible for assessing whether they can continue as a going concern and provide the appropriate disclosures relating to how that assessment was performed and its results (AASB 101 / NZ IAS 1 *Presentation of Financial Statements*).

Financial statements are prepared on a going concern basis unless management either intends to liquidate the entity or to cease trading, or there is no realistic alternative to do so (AASB 101.25 / NZ IAS 1.25). In making this assessment, management must consider all available information about the future, which must extend at least 12 months into the future. If information is available beyond 12 months that is relevant in management's assessment, then it must be included as well. Auditors are required to consider a period of at least twelve months from the date of signing the audit opinion and this will require entities to ensure their forecasts extend to this period.

The assessment of going concern under the effects of COVID-19 will need to incorporate unprecedented shocks to forecasts.

The decreases in asset values, decline in demand for goods and services and supply chain disruptions arising from COVID-19 are being likened to a "black swan" event that is beyond any previously encountered 'real world' scenario, making forecasting the precise results difficult. While the requirements of AASB 101 / NZ IAS 1 are not prescriptive as to how management's assessment is performed, in circumstances where significant uncertainty exists surrounding the outcome of future events, it may be appropriate to model multiple scenarios and weigh their likelihood.

Unfortunately for many entities, 'worst case' scenarios include an assessment whereby little to no revenue for extended periods of time is likely, such as where venues have been instructed to cease normal operations.

'Negative' or 'worst case' scenarios may also need to be weighted quite heavily due to the level of uncertainty as to how the effects of the outbreak will unfold and how long they will endure. The effects of the coronavirus are likely to affect the level of uncertainty that may exist in an assertion that the entity will be able to continue as a going concern.

Regardless of the result of management's assessment, all entities will need to disclose the key judgments and estimates it used to arrive at this conclusion.

Key areas in a going concern assessment may include:

- The sources of assumed liquidity and cash flows, especially in instances where the entity does not have access to enough funds and financing to continue operations based on current contractual arrangements;
- Assumption surrounding compliance with covenants, contractual agreements and/or regulatory requirements;
- Forecasts of future revenue, especially in instances where demand for the entity's primary activities may be significantly reduced for the foreseeable future;
- Assumptions surrounding the length of time and severity to disruptions in supply chains and/or suspension of operations; and
- Support from various levels of government, including intervention on operations and/or financial assistance.

Audit issues entities should be aware of

The auditor will be required to consider all the above when assessing risks and designing audit procedures to respond to those risks.

This is likely to increase the level of audit work required because the impact of COVID-19 on an audit will be pervasive for many organisations.

The list below provides some information that the auditor will consider, which will impact how the audit is conducted.

Risk assessments

Auditors may need to extend their risk assessment procedures to involve more dialogue with management and those charged with governance (TCWG) to fully identify and assess what the impact of COVID-19 is on their business. This could also involve more staff members than typical given the wide-ranging impact the coronavirus is expected to have.

Materiality calculations

Having assessed the risk in the audit, there are likely to be changes to either the inherent or control risk, which will flow into the decisions around calculation of materiality.



Ability to obtain sufficient, appropriate audit evidence

Travel restrictions and social distancing rules are impacting both auditors and entities. Remote working initiatives and access to audit evidence may be challenging.

The auditor will need to consider:

- Electronic audit evidence – remote working and less face to face contact with clients increases the risk of undue reliance on electronic audit evidence. Additional audit procedures may be required to assess the source and veracity of such information, undertaking appropriate testing to confirm its completeness and accuracy; and
- Attendance at stock takes – additional measures are likely to be required where travel restrictions inhibit the ability to conduct stock take attendance. Rules around “social distancing” and hygiene need to be adhered to and may make conduct of these procedures longer than normal. Where attendance at stock takes is not possible, alternative procedures need to be performed, and the auditor will also need to consider the implications on the audit opinion to be issued.

Impact of entity staff movements and shutdowns on segregation of duties and internal controls over financial reporting

Many entities are experiencing financial distress and/or the application of social distancing which is impacting on the number of employees and the roles such employees are undertaking. Breakdowns in internal control could result in the auditor no longer being able to rely on the operating effectiveness of internal controls, which will require changes to the audit approach.

Impact on group auditors (particularly multi-national ones)

Group auditors need to consider how they plan to review component auditors' work to meet the requirements of the standards. This should include assessment of whether alternate procedures are required, for example where travel is restricted making physical access not possible.

Next steps with Crowe

For more information on how these changes impact your organisation, contact the Audit & Assurance team at Crowe Australasia to discuss how we can help you work through the impact on your financial statements and audit process.

Talk to us

Call us on our free phone number 1300 856 065 (AU) 0800 494 569 (NZ). This number will transfer you to your closest office, where we will be happy to connect you with the best person to assist you.

Visit our website

We have a range of tools and ideas to help businesses, as well as specific information about our services and people available on our website.

www.crowe.nz

www.crowe.com.au

Crowe Global is a leading international network of separate and independent accounting and consulting firms that are licensed to use “Crowe” in connection with the provision of professional services to their clients. Crowe Global itself is a non-practicing entity and does not provide professional services to clients. Services are provided by the member firms. Crowe Global and its member firms are not agents of, and do not obligate, one another and are not liable for one another's acts or omissions.

© 2020 Crowe Global

Findex (Aust) Pty Ltd ABN 84 006 466 351, trading as Crowe Australasia is a member of Crowe Global, a Swiss verein. Each member firm of Crowe Global is a separate and independent legal entity. Findex (Aust) Pty Ltd and its affiliates are not responsible or liable for any acts or omissions of Crowe Global or any other member of Crowe Global. Crowe Global does not render any professional services and does not have an ownership or partnership interest in Findex (Aust) Pty Ltd.

Services are provided by Crowe New Zealand Audit Partnership and various Crowe Australasia audit partnerships, affiliates of Findex (Aust) Pty Ltd

© 2020 Findex (Aust) Pty Ltd.

While all reasonable care is taken in the preparation of the material in this guidance document, to the extent allowed by legislation Findex (Aust) Pty Ltd and its affiliates accept no liability whatsoever for reliance on it. All opinions, conclusions, forecasts or recommendations are reasonably held at the time of compilation but are subject to change without notice. Findex (Aust) Pty Ltd and its affiliates assume no obligation to update this material after it has been issued.

The information contained is of a general nature only and does not take into account your objectives, financial situation or needs. You should consider whether the information is suitable for you and your personal circumstances. You should seek personal financial advice before acting on any material.

Liability limited by a scheme approved under Professional Standards Legislation. (AU)

7 April 2020

© Findex Group Limited 2020. All rights reserved