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# Impact of COVID-19 outbreak on the Financial Statements

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## Background

The spread of COVID-19 outbreak and rapid development in many countries have required certain industries to limit and, in some cases, to suspend their business operations and quarantine their stakeholders to be able to contain this crisis. The COVID-19 outbreak occurred exactly at the end of the reporting date, which is the 31st of December 2019 and this novel coronavirus carried on evolving and spread throughout the timeline crossing 31st of December 2019. These measures and policies taken and will be taken by the government will have a negative impact on the profitability and might also jeopardize the entities' business sustainability and disrupt their business activities. Therefore, entities must be prepared by assessing the risk that would encounter, detect it, and take all preventive actions and remedies to mitigate its impact on their business activities.

Entities' management cannot wait and build up their judgments based on what will happen in the upcoming weeks. Entities should consider this crisis as a threat of having a direct negative impact on their business and create different plans to manage their cash flow management system and mitigate the loss to the extent of ensuring its business sustainability and avoid any going concern issue.

COVID -19 outbreak has a direct impact on certain sectors such as F&B, entertainment, tourism, hospitality, retail, and transportation; however, there will also have a knock-on effect on other industries such as manufacturing, construction and financial sector. Therefore, entities may face challenges while preparing financial statements due to recent circumstances. Entities should prepare the financial statements based on International Financial Reporting Standards, and therefore, the financial impact of this COVID-19 outbreak should be reflected in the financial statements even if the event takes place after the reporting date, which is the 31 st of December 2019.

The facts that we are going to discuss are by no means exhaustive, and their applicability depends on each entity's facts and circumstances.

The financial reporting issues that each entity should consider are highlighted in brief in this publication as followed:

- Going concern
- Events after the reporting period
- Expected credit loss assessment

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## Going concern

International Accounting Standards (IAS)1 requires management to prepare its financial statements on a going concern basis unless management intends to liquidate the entity, to cease its operation, or has no realistic alternative but to do so. Therefore, management is required to assess, at the time of preparing the financial statements, the entity's ability to continue as a going concern, and this assessment should cover the entity's prospects for at least 12 months from the end of the reporting period. The 12 -months period for considering the entity's future is a minimum requirement; an entity cannot, for example, prepare its financial statements on a going concern basis if it intends to cease operations after18 months from the end of the reporting period. The existence of any material uncertainty that casts doubts about the entity's ability to continue as a going concern is not sufficient reason to depart from preparing financial statements on a going concern basis.

Management should elaborate all information about the future, which is at least but not limited to 12 months to be able to assess the going concern appropriately. When making that assessment, management should consider the COVID-19 outbreak and its impact on the business activities for the upcoming 12 months. For example, if the entity was profitable in the previous year but due to the impact of the outbreak, its business operation is suspended, or there is a high probability that the business operation will be suspended in the upcoming weeks.

Thus, management should consider various factors to be able to mitigate this adverse impact by;

- Cutting no-essential expenses,
- Allocate employees to communicate with your customers and collect all due amounts.
- Extending suppliers' payments to be able to minimize the cash conversion cycle and cover the cash flow gap between the inflow and outflow.
- Find out alternate vendors if they are unable to deliver goods at this time.
- Save your cash, planning for varying lengths of time of reduced revenue flow.
- Communicate with your bank about increasing your facility in which you can use as a safety during a time of cash-crunch.
- Keep your staff morale up. It is during uncertainty when transformational leadership is required most. They need to feel assured that you have an effective plan, which will keep them along with the business healthy .

Management should consider all available information, which was obtained after the 31 st of December 2019, assess the going basis, and make it clear to the primary user of the financial statements the potential impact of the outbreak and its effect on the entity's going concern. This disclosure is required based on IAS 10 , events after the reporting period and the date on which the financial statements are authorized for issue in which is discussed in the next section. Finally, the degree of consideration is required depending on the facts and circumstances of each entity.

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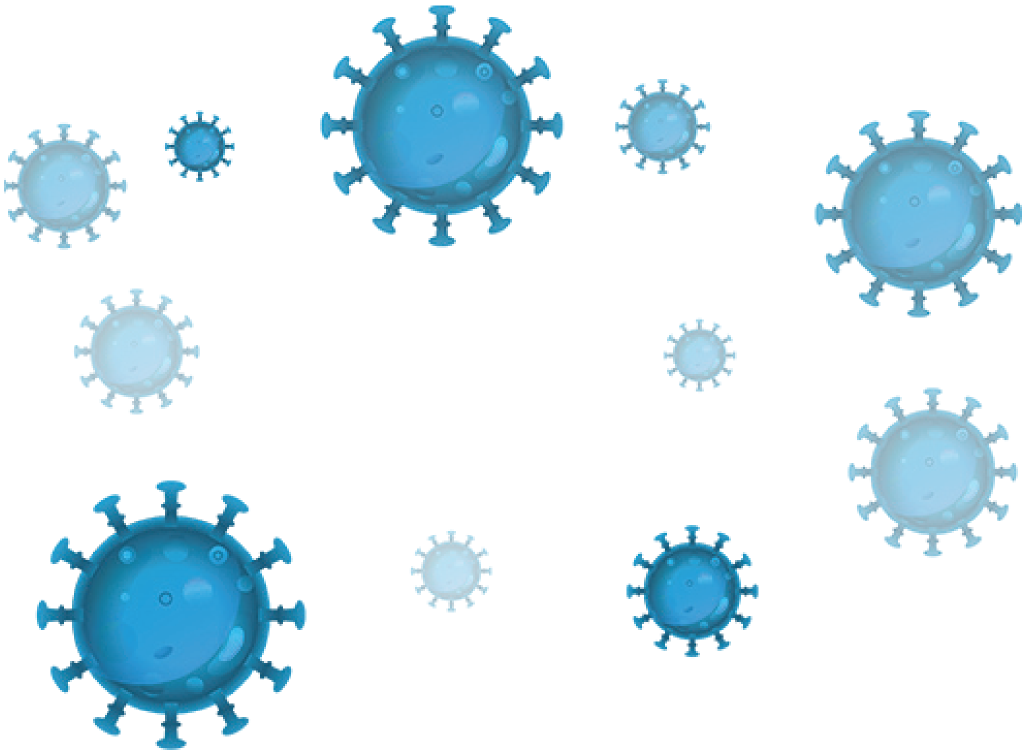
# Events after the reporting period

IAS 10 applies to the accounting and disclosure of events that happen between the balance sheet date and the date when the financial statements are authorized for issue. IAS 10 distinguishes between events that require changes in the amounts to be included in the financial statements ('adjusting events') and events that only require disclosure ('non-adjusting events').



# Events after the reporting period (continued)

For entities that are affected and would be impacted by the outbreak should take into consideration all the necessary information obtained after the reporting date and make the judgment accordingly. Any potential impact that would have a financial effect and provide evidence of conditions existing at the reporting date, then management should reflect the amounts in the financial statements. However, if the potential impact provides indicative of conditions that arise after reporting date, then entities should disclose these non-adjusting events in the notes to financial statements if the amounts are material.

To illustrate the above, if the government imposes a quarantine on all factories that are located in specific locations, such as the industrial area (similar to what is happening recently) to be able to contain the outbreak, then this closure is a non-adjusting event that requires the management to adjust the assets and liabilities at the reporting date. However, the management should disclose this event in the notes to financial statements if the impact of this suspension on its business activities is material to the financial statements. Also, if the government imposes a quarantine on the workers that are living in a compound and this process led to suspend the business activity of the entity; thus, this requires the management to assess this event and its impact on the financial statements and disclose it in the notes to the financial statements.

Adjusting events that happen between the reporting date and the date the financial statements authorized for the issue will have an impact on the financial statements as of 31 st December 2019 .

Examples of adjusting events include:

- The settlement of a court case after the balance sheet date that confirms that the entity had a present obligation at the balance sheet date. The entity adjusts any existing provision for the obligation or creates a new provision.
- The receipt of information, after the balance sheet date, indicating that an asset was impaired as at the balance sheet date; for example, the bankruptcy of a customer that occurs after the balance sheet date, or the sale of inventories after the period end, that gives evidence about their net realizable value at the balance sheet date.
- The determination, after the balance sheet date, of the consideration for assets sold or purchased before the balance sheet date.
- The determination, after the balance sheet date, of profit-sharing or bonus arrangements, if the entity had a present legal or constructive obligation to make such payments as a result of events before the balance sheet date.
- The discovery of fraud or errors that show that the financial statements are incorrect.

## Expected credit loss assessment

IFRS 9 Financial Instruments requires management to consider past events, current conditions, and the forecast of future economic benefit into an assessment of measuring Expected Credit Losses (ECL). This assessment should be based on the reasonable and supportable available at the reporting date, along with looking-forward information that happens between the date of the reporting date and the date of the financial statements authorized for the issue. Using the simplified approach for the trade receivables that result from transactions within the scope of IFRS 15 (assuming that they do not contain a significant financing component), we highlight some factors that entities should consider to measure the Expected Credit Losses (ECL).

An entity should assess the impact of COVID-19 on its accounts receivable by assessing the following:

- Creditworthiness of the client.
- Is the client-facing a severe problem in sustaining its business? Then, the management cannot receive the due amounts that were expected to be collected between the reporting date and the date of authorizing the financial statements for issue.

- The IFRS Transition Group for Impairment of Financial Instruments (ITG) noted that IAS 10 Events after Reporting Date states that bankruptcy of a customer that occurs after the reporting period usually confirms that the customer was credit-impaired at the end of the reporting period and is, therefore, an adjusting event, which means the management should adjust the amount at the reporting date (31 st of December 2019 ).

**Disclosures**:

IAS 1 requires entities to disclose such information in the financial statements even though it is not clear about the current and future economic benefit of the customers. However, this disclosure enables financial statements' users to understand the impact of the outbreak. This uncertainty leads to the need to provide disclosures required for non-adjusting events by IAS 10 namely;

- the nature of the event – the novel COVID -19 outbreak and
- an estimate of the financial effect of that event, or a statement that such an estimate cannot be made.

From a practical perspective, this would often mean rerunning the ECL exercise with, or without adjusting it for, the latest available information on a date close to when the financial statements are authorized for issue.

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