A Closer Look

Accounting implications of the COVID-19 outbreak on IFRS consolidated financial statements as at 31 December 2019

On 30 January 2020, the World Health Organization (WHO) declared a Public Health Emergency of International Concern over COVID-19 outbreak, which was then further qualified as pandemic on 11 March 2020. Containment decisions and announcements of governments' support to the economies were taken subsequently on different time scales around the world. In this context of major uncertainties, all European stakeholders involved in accounting standardisation[1] have been mobilising to address concerns, both under IFRS and local GAAP, about the impacts of the crisis on financial statements as at 31 December 2019. This study sheds light on the key convergent positions issued for that purpose from an IFRS point of view.

1. The accounting qualification of the post balance sheet events:

- the post balance sheet events related to the COVID-19 outbreak have been unanimously qualified as **non-adjusting events** under IAS 10 at 2019 year-end, as the sudden spread of the infections and the WHO's global alert did not occur until January 2020;
- as a consequence, **IFRS preparers <u>shall not adjust</u> the amounts** recognised in the consolidated financial statements as at 31 December 2019, unless the entity's going concern assumption is seriously undermined (see further development below);
- the subsequent measurement of assets and liabilities shall therefore only reflect the conditions that prevailed at 31 December 2019 (i.e. irrespective of the effects of the crisis). Additional and tailored disclosures should be considered if management is already expecting that the current events will lead to material adjustments to the carrying amounts of assets and liabilities within the next financial year.

Examples of events occurring after the reporting period that do not give rise to adjustments of amounts recognised as at 31 December 2019: drop in the share price of financial assets measured at fair or actual value, banking covenants breakage, governments' actions in 2020 that could not have been anticipated at 2019 year-end…

Examples of implications of the outbreak that shall not be considered in the measurement of assets and liabilities as at 31 December 2019: impacts on inventories' net realisable value, impacts of the erosion in credit quality on loans and trade receivables, future operating losses, costs of measures of partial activity, decrease in fair value of assets, deterioration of budgets used to evaluate future cash flows for impairment tests…

[1] Such as CNCC & CSOEC (France), ICAEW (UK), IDW (Germany), etc.; see complete publications follow-up on Accountancy Europe dedicated hub

2. The assessment of the going concern assumption:

- the entity should assess (i) whether there is any material uncertainty on its ability to continue as a going concern, that can result in additional disclosures (see below), or (ii) whether it is still appropriate to prepare its IFRS accounts on a going concern basis;
- thus, the going concern basis is still appropriate unless management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so;
- the entity should consider **all available information about the future.** Regarding the timeframe, IAS 1.26 clearly states that the entity needs to consider **at least the first twelve months from the end of the reporting period**. As the going concern assessment shall be conducted **up till the date when the financial statements are authorised for issue** (to be compliant with the assessment of events after the reporting period under IAS 10), it can also be considered that the timeframe shall apply from that date. In any case, management needs to consider an appropriate timeframe that may be longer than the minimum period of twelve months while taking account of the facts and circumstances of each specific situation;
- in practice, it could be expected that the going concern basis will not be used only if COVID-19 forces a company out of business. If so, IFRS consolidated financial statements as at 31 December 2019 shall be prepared **from a business termination perspective** (e.g. on the basis of net asset values).

3. The impacts on disclosures within the notes to IFRS financial statements:

- under non-adjusting events requirements (IAS 10.21): entity-specific information shall be given on the nature of any material non-adjusting event, as well as an estimate of its financial effect (or a statement that such an estimate cannot be made);

Examples of consequences related to the COVID-19 outbreak that should be disclosed as non-adjusting events information: significant decrease in sales and operating cash flows, significant losses on contracts, trigger of application of specific material contractual clauses, banking covenants breakage, debt renegotiations, disruptions in production or supply chains, factory and/or shops closures, restructuring plans…

Examples of impacts on the carrying amounts or classification of assets and liabilities in the balance sheet that should be disclosed in the notes where material: impairment of tangible and intangible assets, impairment of trade receivables, contract assets and loans, measurement at fair value, end of hedging relationships, recoverability of deferred tax assets, reassessment of share-based payments, accounting of restructuring or onerous contracts provisions, redundancy plans, banking covenants breakage…

- under going concern requirements (IAS 1.25 & IAS 10.16):
  - if the entity does prepare its financial statements on a going concern basis, it shall disclose **any material uncertainty in connection with events or circumstances that could cast significant doubt on its ability to continue as a going concern**. The entity shall also describe the significant judgments exercised by management to conclude the going concern assumption is still appropriate despite the existing uncertainties;
  - if the entity does not prepare its financial statements on a going concern basis, **it shall disclose that fact**, together with the basis on which it prepared them (needing therefore to update its accounting policies) and **the reason why the entity is not regarded as a going concern;**
- under estimation uncertainty requirements (IAS 1.125 and following): the entity shall disclose information about the **assumptions it makes about the future, and other major sources of estimation uncertainty** at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Key points to remember

- The post balance sheet events that are caused by the COVID-19 outbreak:
  - **shall not give rise to adjustments** to the amounts recognised in IFRS consolidated financial statements as at 31 December 2019,
  - unless such events **seriously call into question the validity of the going concern assumption** for the entity (i.e. where an entity can no longer prepare its financial statements on a going concern basis).
- Consequently, the COVID-19 crisis impact on IFRS consolidated financial statements as at 31 December 2019 is limited to **disclosures only**. The information provided should enable users to assess the **major sources of estimation uncertainties** affecting the carrying amounts of assets and liabilities.

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