Financial Reporting
Implications of the Coronavirus Outbreak

by Alan Bailie

The outbreak of Covid-19 has already had a significant impact on businesses both in Ireland and worldwide. Businesses across a variety of sectors have already seen significant declines in turnover, disruption to both supply chains and workforces and in many cases have been temporarily closed as a result of the restrictive measures imposed by Governments to slow the spread of Covid-19.

While first and foremost the outbreak of Covid-19 is primarily a public health issue, the crisis will have financial reporting implications for financial years ended in 2019 and 2020 that both accountants and preparers of financial statements need to be aware of when preparing financial statements.

This article sets out some of the main financial reporting considerations of the outbreak of Covid-19 for entities preparing financial statements in accordance with Financial Reporting Standards applicable in the UK and Ireland, including:

a. **Events after the reporting period,**

b. **Going Concern,**

c. **Impairment,**

d. **Government grants; and**

e. **Other**

Events after the reporting period

Management are responsible for the preparation of the financial statements which show a true and fair view of the assets, liabilities and financial position of the company at the balance sheet date and of the profit and loss of the company for the financial year. In preparing these financial statements they are required to consider all events up to the date when the financial statements are authorised for issue.

Section 32, FRS 102 'The Financial Reporting Standard Applicable in the UK and Republic of Ireland' [1] provides for two types of event after the reporting period, adjusting and non-adjusting . The critical factor in determining whether an event is an adjusting or non-adjusting event is whether that event provides evidence of conditions that existed at the balance sheet date. If so, it will be an adjusting event requiring adjustment of amounts recognised in the financial statements including related disclosures.

The World Health Organisation (WHO) were first informed of a pneumonia of unknown cause by China on 31st December 2019, with the virus being labelled by the WHO as a pandemic on 11th March 2020. In the period between 31st December 2020 and 11th March 2020 the timeline by which the virus began to have a significant impact varied by continent and country. Our own 'stay at home' measures were announced by the Government on 27th March 2020.

For financial years ending 31 December 2019 the general consensus is that the outbreak is likely a non-adjusting event, with disclosure required of the nature of the event and an estimate of its financial effect or a statement that such an estimate cannot be made[2].

When does the effects of Covid-19 become an adjusting event?

For financial years ended in 2020 there is unlikely to be a universal flip point at which the effects of Covid-19 becomes an adjusting event, rather management will be required to exercise significant judgement in this regard taking account of the specific facts and circumstances of the entity and its operations.

For example, does the business have foreign operations and how has the effects of the virus impacted supply chains? Where the business has foreign operations, or its supply chain is reliant on other jurisdictions, management will need to consider the individual timelines for those jurisdictions in determining whether the effects of coronavirus represent an adjusting event in preparing the financial statements.

Small and Micro Companies Regimes

Where an entity prepares its financial statements in accordance with Section 1A, FRS 102 an event is an adjusting or non-adjusting event is determined in accordance with the principles outlined above. Paragraph 1AD.54 addresses similar disclosure requirements to that contained in 32.10, FRS 102 requiring disclosure of the particulars and financial impact of material events after the reporting period in the notes to the Financial Statements.

For entities preparing financial statements in accordance with FRS 105 The Financial Reporting Standard applicable to the Micro-Entities Regime, Section 26 contains similar principles to determine whether an event is an adjusting or non-adjusting

[1] Para 32.2 FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland, Para 26.2 FRS 105, The Financial Reporting Standard applicable to the Micro-entities Regime
[2] Para 32.10 FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland

event. Unlike FRS 102 including Section 1A there are no disclosure requirements for entities preparing financial statements in accordance with FRS 105.

Going Concern

The impact of Covid-19 has caused a significant deterioration in economic conditions for many companies across a variety of sectors. While for some 'essential businesses' there may be little or no impact, others are already experiencing significant impacts for their business with declining turnover and disruptions to supply chains and the workforce. In many cases non-essential businesses have been closed as a result of the restrictive measures announced by Governments to combat the spread of coronavirus. Going concern is therefore likely to be an issue for management in many cases when preparing financial statements.

A company is presumed to be carrying on business as a going concern in accordance with the Companies Act 2014. Under Both FRS 102[3] and FRS 105[4] financial statements are prepared on the going concern basis unless management;

- Intends to liquidate the entity, or cease trading; or
- Has no realistic alternative but to do so

Under both financial reporting frameworks management are required, in preparing the financial statements to assess the entity's ability to continue as a going concern. This assessment should take account of all available information about the future, including the effects and potential effects of coronavirus, taking account of a period of at least twelve months from the financial statements are authorised for issue.

Management's assessment of an entity's ability to continue as a going concern is often based on budgets and forecasts, which for 2020 will likely have been prepared in 2019. Ongoing revisions of budgets and forecasts by management will be required by management to reflect the changing economic circumstances and to support their assessment.

Going concern basis – not applicable?

It is inevitable that some businesses will not survive the current crisis. Where management determine that the business is not a going concern both FRS 102 and FRS 105 require that the financial statements be prepared on a basis other than going concern, for example the break-up basis.

Para 3.9, FRS 102 requires disclosure of this fact together with the basis on which the financial statements have been prepared and the reason(s) why the entity is not a going concern. For an entity preparing its financial statements in accordance with the 'small companies regime' disclosure is required of the following information in accordance with para 1AD.11 of FRS 102 - true and fair override;

- The reason(s) for the departure from company law;
- The effects of the departure on the Profit & Loss and Balance Sheet.

The disclosure requirements noted above do not apply to an entity preparing its financial statements in accordance with FRS 105

Material uncertainties

Where management concludes that the going concern basis of accounting is appropriate, but material uncertainties related to events or conditions that cast significant doubt on the entity's ability to continue as a going concern, those uncertainties should be disclosed in the notes to the financial statements[5].

While disclosure of material uncertainties related to going concern are only encouraged for entities preparing financial statements

under the small companies regime[6], preparers of financial statements should be consider whether disclosure is necessary for the financial statements to show a true and fair view as required by Section 289 Companies Act 2014.

Disclosure is not required by entities preparing financial statements in accordance with the micro companies regime of material uncertainties related to going concern.

Impairment

The impact of Covid-19, on the markets and the economic environments in which businesses are operating, is potentially a triggering event requiring an impairment review. Examples of assets affected include:

- Tangible fixed assets;
- Intangible assets including goodwill;
- Stock;
- Investment property (measured at cost);
- Investments in associates and joint ventures.

---

[3] Para 32.7A FRS 102, The Financial Reporting Standard applicable in the UK and Republic of Ireland
[4] Para 26.8 FRS 105, The Financial Reporting Standard applicable to the Micro-entities Regime
[5] Para 3.9 FRS 102, The Financial Reporting Standard applicable in the UK and Republic of Ireland
[6] Para 1AE.2 FRS 102, The Financial Reporting Standard applicable in the UK and Republic of Ireland

An asset is impaired where the recoverable amount of the asset is less than the carrying amount, with the resulting impairment loss generally being recognised immediately in the profit and loss account unless the asset is carried at a revalued amount.

Recoverable amount is the **higher** of its fair value less costs to sell and its value in use.

The fluid nature of the Covid-19 outbreak will present challenges for companies in calculating recoverable amount, for example,

- there may not be an active market to determine the assets fair value less costs to complete and sell; and
- it may be difficult to estimate future cashflows for the purpose of the value in use calculation given the uncertainty as to how long the crisis is likely to last.

An impairment loss is generally recognised immediately in the profit and loss account, except where the asset is carried at a revalued amount in accordance with another section of FRS 102. An impairment loss on a revalued asset is treated as a revaluation decrease in accordance with the relevant section.

Debtors

Trade debtors are generally recognised as basic financial instruments in accordance with Section 11 of FRS 102. A company is required to assess at the end of each reporting period whether there is objective evidence that a financial asset is impaired, where there is objective evidence of impairment this should be recognised immediately in the profit and loss account.

Paragraphs 11.22 and 11.23 of FRS 102 provide some examples of objective evidence including significant financial difficulty of a debtor, evidence of bankruptcy or restructuring and significant changes in the market or economic environment of the debtor. The impact of Covid-19 is therefore likely to be a triggering event requiring an impairment review of debtors.

Government Grants

Governments around the world have responded through introducing a range of economic measures and supports, to assist businesses in dealing with the fallout of the Covid-19 pandemic.

The Glossary to FRS 102, FRS 102 The Financial Reporting Standard Applicable in the UK and Republic of Ireland defines a government grant as *"Assistance by Government in the form of a transfer of resources to an entity in return for past or future compliance with specified conditions relating to the operating activities of the entity"*.

Government assistance in the form of benefits that may impact on a company's taxable profit, for example reduced tax rates and extended periods in which to use tax losses, are generally accounted for in accordance with Section 29 of FRS 102 - Income Tax.

Management will therefore need to carefully consider all forms of government assistance that the company is in receipt of in order to determine the appropriate accounting treatment.

Other

While the above discusses some of the main financial reporting implications of the Covid-19 outbreak, the overall impact that the crisis has on financial reporting will be determined by the individual facts and circumstances of each company. Some other areas to consider include;

- Has a deterioration in the company's operating results and financial positions triggered a breach of a debt covenant, requiring long term debt to be re-classified as payable on demand?
- Are deferred tax assets recoverable?
- Are employee benefits affected, for example termination benefits and defined benefit pension schemes?
- Does the company need to recognise additional provisions? For example, have contracts become onerous as a result of the outbreak or do contracts include penalties for failures to fulfil contractual obligations?

Conclusion

The fallout of the Covid-19 pandemic will undoubtedly have significant implications for management and preparers of financial statements for both 2019 years ends and beyond. How the crisis impacts on the financial statements of companies will be determined by the individual facts and circumstances of each company.

Alan Bailie,
Knowledge Manager,
CPA Ireland