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COVID-19 Impact on 2020 Financial Statements

In this edition of the Advisory & Assurance Pulse we want to focus on the attention points and in particular to provide guidance over the implications of COVID-19 on financial reporting standards (eg IFRS, IFRS for SMEs and Dutch GAAP).

Telling the COVID-19 story and reporting the impact of the global pandemic in the financial statements will, for many reporting entities, be a challenge. As preparer of the financial statements, you will need to think about how, where and in what form you should report COVID-19 in your financial statements.
We believe it is important to not only comply with the guidance set out in reporting standards, but also ensure that the financial statements are an effective part of any wider communication the entity intends to share with its stakeholders. COVID-19 will be the main focus of the financial statements for reporting entities in 2020, be it positive or negative, and whatever happens the consequences of this pandemic will still be prominent next year, so financial statements with an annual reporting date in 2020 should be prepared with that in mind.

Telling the COVID Story

Financial Statement Impact

In relation to the preparation of financial statements for the year ending 31 december 2020, there are specific items to take note of in respect of the impact of COVID-19.
An entity should present additional line items when it is relevant to an understanding of the entity's financial position, financial performance or its cash flows. Whilst an entity is allowed to add lines into its financial statements in respect of the impact of COVID-19, it is important to ensure COVID-19 related matters are not given undue prominence.

When preparing financial statements bear in mind that an unusual or new type of transaction is more likely to be material than a routine or regularly occurring transaction of the same size.
Some examples of items considered 'unusual' that could warrant disclosure and that may otherwise fall below materiality thresholds, and some of these items could be relevant when reporting on the consequences of COVID-19 are highlighted in the following section "Impact by COVID19 on Financial Statement Line Items". In respect of the notes to the financial statements, the ordering of the notes could potentially change this year if the impact of COVID-19 changes their significance or importance (for example notes on going concern, impairment or events after the reporting date). When making disclosures in financial statements, the more uncertain the environment, the more detailed the disclosures of the assumptions and assessments used to prepare the financial statements should be (for example changes in useful lives, changes in discount rates as a result of changes in market conditions, government grants received etc.)

When reporting on the economic consequences of the pandemic on the reporting entity a key factor is considering whether the message is communicated in a consistent and coherent way. It should always align with any narrative contained elsewhere in the annual report.

Our view when drafting content for the annual report and the financial statements, is that as preparers you should question:

1 what is important to the business and what are its main objectives?

2 are these objectives consistent throughout the annual report?

3 is the right level of emphasis being placed on disclosures relating to COVID-19?

4 are the messages about the impact of COVID-19 consistent?

5 is the disclosure sufficient for the reader to be able to understand the impact of COVID-19 on the entity and assist them in making economic decisions?

6 are the Financial Statements using the same terminology between the Financial Statements and management commentary that are being referred to? For example, if the statement of financial position is referred to as the balance sheet, is reference to the balance sheet made consistently throughout the report – rather than switching between the two titles for the same Financial Statement?

7 a cashflow statement projection is required to be prepared by all entities for a period of minimal 1 year and advisable is to do this for a period 2 year after balance sheet date.

8 events after the reporting date.

9 restructurings of the activities of an entity and reversals of any provisions for the costs of these restructurings.

10 discontinued operations

11 litigation settlements, and

12 other reversals of provisions.

Impact by COVID-19 on Financial Statement Line Items

Government Subsidy

The Government of Bonaire has introduced the Emergency Funds for Social Assistance in respect of salary subsidies and company cost subsidies, you are required to present this adequately in your financial statements.

Revenue

You should review your revenue accounting policies and estimates to make sure they are still applicable given the current circumstances.

Property Plant & Equipment

You should consider the impairment testing of goodwill, other intangible assets and property, plant and equipment. Also consider disposals of items of property, plant and equipment.

Fair value measurement

The fair value of an item (such as certain financial instruments, investment properties, and items of property, plant and equipment that are subject to systematic revaluation due to an accounting policy choice) must reflect market participant views and market data at the measurement date under current market conditions.

There may be an increase in the amount of subjectivity involved in fair value measurements because of the impact of COVID-19. Be attentive for triggers due to external factors, some indicators of impairment that may exist as a result of the economic conditions caused by the spread of COVID-19 are investments other than portfolio investments (eg a subsidiary that is not consolidated), significant financial difficulty of the investee, a breach of contract (eg default or delinquency in debt payments).

It is probable that the investee will enter bankruptcy or other financial reorganization, a significant adverse change in the economic or legal environment in which the investee operates (eg recession), or the disappearance of an active market for the investment because of financial difficulties of the investee.

Changes to existing valuation techniques and inputs may be required in response to the current market conditions and depending on the significance of the amounts involved, management should consider obtaining assistance from external valuation specialists who possess the necessary expertise, experience and market knowledge required to properly apply the reporting standards.

Providing transparency over the valuation techniques used and key assumptions and inputs used in determining fair value, including the sensitivities by providing disclosures required by the standards, is an integral part of determining fair value and they are key to enhancing the usefulness of financial reporting in this unprecedented time to the users of financial statements.

Leased Assets

For lessee and lessors there are implications such as lease modifications, changes in the incremental borrowing rate (IBR), due to the pandemic including changes to interest rates and to your entity's own credit risk, this rate may need to be reconsidered. Impairment on right of use assets, it should be evaluated if there are any indicators of impairment, if this is the case your entity should test these for impairment.

Financial Instruments

Due to the rapidly changing economic environment, you may find that your organization is subject to new or increasing risk (eg credit, liquidity, or market risk) or concentrations of risk. In addition, you may find that risks have changed from the prior period. Management should evaluate whether additional risk disclosures are required.
Some reporting standards (eg IFRS) require that entities disclose a sensitivity analysis (including quantitative disclosures) pertaining to changes in the relevant risk variable that are "reasonably possible" at the reporting date. Management may need to perform sensitivity calculations using a larger range for the risk variables or consider a direction of change that reflects expectations resulting from the COVID-19 pandemic.

Inventories

Some entities may be experiencing supply chain disruptions. Seasonal inventories and perishable products might be exposed to the risk of loss due to damage, contamination, physical deterioration, obsolescence, or changes in price levels. A reporting entity needs to assess whether, on the reporting date, an adjustment is required to the carrying value of their inventory to bring them to their net realizable value. Estimating net realizable value in such volatile market conditions may also be a challenge on account of the uncertainties presented by the pandemic.

Provisions, contingent assets and contingent liabilities

If your entity has to make additional provisions in relation to COVID-19 then these should be explained in the financial statements. However, it is important to remember provisions should only be made if there is a legal or constructive obligation in place at the reporting date.

Significant management judgement in applying accounting policies

The financial statements need to provide enough transparency to enable users to understand the key assumptions that have been adopted so they can make their own assessment of their reasonableness. Therefore, it is reasonable to provide more detail in those judgements that may have been impacted by COVID-19. In addition, there may be additional judgements made in this year's financial statements that now need to be disclosed, for example going concern.

Estimation uncertainty

The focus is on assumptions the entity makes about the future. Some examples to take into considerations are the nature of the assumption, sensitivity of carrying amounts, the expected resolution/range of reasonably possible outcomes and changes made to past assumptions.

Borrowings

Some financial institutions (and other creditors) are providing holders of debt with an option to defer principal payments for a period of time. Management will need to assess whether the change in terms represent a modification or extinguishment of the debt obligation and revisit the portion of the debt that is considered current versus non-current.

Deferred tax assets

If your entity has historically recognized a deferred tax asset in its statement of financial position may, you need to revisit its assumptions about the likelihood that it will be realized in the future. Management may need to determine that it is no longer appropriate because it is no longer

Trade and other receivables

The negative economic outlook and cash flow difficulties experienced by customers as a result of the impact of COVID-19 must be factored into your entity's forecasts of future conditions, which may result in an increase in its allowance of trade and other receivables.

Disposal groups classified as held for sale and discontinued operations

As a result of the difficult economic environment, your entity may be considering or implementing restructuring plans such as the sale or closure of part of its business or the downsizing of operations (either temporary or permanent). Management should consider whether any long-lived assets need to be classified as held for sale or if any portion of its business qualifies for presentation as a discontinued operation.

Employee remuneration

Some entities are providing additional benefits to their employees such as: paying them during a temporary shutdown of their operations, or while they are sick or in mandatory quarantine, and/or providing other compensation to assist employees with working remotely.

If your entity decides to provide new benefits to its employees, you must determine how to account for the benefits. It will likely meet the definition of a liability; therefore, an entity will need to consider when to recognize the liability/expense and how it should be measured.

Trade and other payables

Trade and other payables may be impacted if your entity is adjusting their terms of trade with suppliers. In addition, short-term bank overdrafts could increase if limits have been exceeded. Ensuring disclosures of such situations are made if these liabilities have changed significantly will help the users of the financial statements better understand the liquidity and cash flow position of the entity.

Tax expense

Tax reforms as a means of supporting business in 2020 have been adopted by the Government of Bonaire. This could impact the tax disclosures. Therefore, the impact reform as such should be recognized and disclosed in your financial statements.

Related party transactions

Economic dependence – if your entity is otherwise not economically dependent on another entity or individual may find that circumstances change during this period of crisis. Management should consider whether disclosure regarding economic dependence should be added to the financial statements.

Guarantees – if your entity has provided guarantees to related parties as a result of the impact of COVID-19, you will need to consider whether a liability should be recognized in the financial statements.

We hope you find this information helpful in giving you some insights for your organization. If you would like to discuss any of the points above, get in touch with your local Grant Thornton contact or email us via info@bq.gt.com

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