ACCOUNTING IMPLICATIONS OF THE CORONAVIRUS DISEASE (COVID-19) OUTBREAK

The Coronavirus Disease 2019 (COVID-19) outbreak has had a significant impact on the global economy. Businesses have encountered disruptions in production, in their value chains and the nature of their operations. Both short term and long term impacts are expected in processes and value creation. Unavailability of personnel, distribution and sales channels due to various social distancing measures implemented by governments requires significant changes in how organisational functions are carried out. The accounting function has not been spared and BICA has developed this guide to highlight some of the key issues to be considered by accountants in preparing financial statements for periods ending on or after 31 December 2019.

These are troubling times, and it is only natural that those who master the language of business should reflect on what they need to consider in order to be able to still present a faithful account of the results and financial positions of business to stakeholders who rely on the information for decision making.

- **Material judgements and uncertainties**

  There is a lot of uncertainty due to the Covid-19 outbreak. Most economic indices have become very volatile and it is difficult to predict how long this situation is going to last. It is difficult to forecast any economic index at the moment, be it the inflation rate, the unemployment rate, interest rates, economic growth rates etc. The pandemic has made significant judgements and their assessment much more difficult than it has been in the past. It would be necessary to have a harder look at the information that backs the judgements made in preparing financial statements. It goes without saying that Going concern assessments would also be much more difficult with the economic uncertainties surrounding us at the moment.

- **Events after the end of the reporting period**

  IAS 10 *Events after the Reporting period* is especially topical for entities with a December 2019 yearend due to the timing of the outbreak. At the end of each reporting period, entities are expected to evaluate information that becomes available after the reporting date but before the issuance of the financial statements. They would then be able to identify adjusting events, that provide evidence of conditions that existed at the end of the reporting period, requiring adjustments to yearend financial statements. They would also be able to identify non-adjusting events, which are indicative of conditions that arose after the reporting period. If these are material, then an entity would be expected to disclose the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made. At 31 December 2019 there were few reported cases of COVID-19 and little confirmed evidence of its spread so in our opinion it would be difficult (especially for an entity based in Botswana) to argue that the outbreak is an adjusting event. However, preparers need to consider that the effects of the subsequent outbreak and decisions made in response to the outbreak may require disclosure in the financial statements even though not affecting the amounts recognised.

- **Impairment of non-financial assets (including goodwill)**

  It is a distinct possibility that COVID-19 may impact the measurement of assets and liabilities in some entities' financial statements. IAS 36 *Impairment of Assets* requires entities to perform an impairment test at the end of each reporting period when there is any indication that a cash generating unit may be impaired. In assessing the possibility of impairment, entities should consider 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 manner in which, an asset is used or is expected to be used (e.g. asset becoming idle, plans to discontinue or restructure operations etc.)

  As a result of the impact of COVID-19, in our opinion entities may need to assess whether the impact of COVID-19 has led to asset impairments. They should also consider whether estimates of future cash flows and earnings, may be significantly affected by the direct or indirect impacts of the virus outbreak.

- **Valuation of inventories.**
  One of the issues associated with the imminent lockdown is that fixed overheads will still be incurred while production suffers a temporary shutdown. The goods produced during such a period for instance would still have to absorb the cost of overheads, which would now be spread over lower output values than anticipated. IAS 2 *Inventories* requires inventories to be measured at the lower of cost and net realisable value. The lockdown and other measures are causing significant changes in costs and on the other hand, demand patterns are evolving as consumers adjust to the changes in lifestyles and the way of doing business brought about by the pandemic. Both cost and Net Realisable Value calculations are going to be significantly impacted.

- **Allowance for expected credit losses (ECL).**
  An expected credit loss is the product of two components. The one component is the Probability of Default (PD) and the other is the loss given default (LGD). The PD is how likely the debtor is to default on payment to the institution and is usually computed using a series of actuarial modeling in percentage terms. The LGD is how much the institution stands to lose (not recover) should the debtor default on payment. Factored into that calculation is any collateral that the institution may have secured over the loan, for example inventory, shares, debtors etc...

  COVID-19 and the measures implemented to manage it like the lockdown can impact the ability of borrowers, whether corporate or individuals, to meet their obligations under loan relationships. In simple terms, the inability of the entity's customers/debtors to generate cash increases the probability that the customer may default. More broadly, reductions in forecasts in economic growth increases the probability of default across many borrowers and loss given default rates may increase due to the fall in value of collateral evident more generally by falls in prices of assets.

The lockdown called by the state president certainly gives indicators that this virus may have a material and negative impact on the economy. It indicates the potential increase from a stage 1 level of impairment (12 month) to stage 2 level (lifetime) of impairment for affected debtors. In summary, the increase in the risk of non-payment by clients will at a minimum require an increase in the ECL calculation to that of a life time credit impairment. Furthermore, any defaults already incurred, i.e. customers who have failed to honour their payment commitments, or whose payments did not successfully clear the bank suggest that these debtors are already credit impaired which may trigger a stage 3 impairment. This would then classify the debt as credit impaired. Due to the uncertainty of the duration, timing and longer term impact that the Covid-19 virus may have, these calculations may be difficult.

- **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.
- Contracts for delivery of services in the education or tourism sectors which oblige entities to provide services to smaller groups than is economically viable.

Conclusion

As a matter of course, this is not intended to serve as a conclusive list of the possible issues we may have to grapple with as accountants and auditors. There are also wider business implications that we will be expected to advice our principals on throughout this challenging period. This notice is intended to serve as a prompt for all of us in the profession to seriously consider the implications of the most disruptive event in recent history on our employers, our clients and the way in which we practice our profession.

As we go into the national lockdown at midnight on the 02nd of April 2020, rest assured that the technical team of the Institute would be reachable electronically every day during business hours throughout the lockdown period. As you work from home, feel free to contact us if you have any technical query or require any form of technical support at BICA-Technical@bica.org.bw.

Stay safe, wash your hands, practice social distancing, sanitise your environment and remain dedicated to faithful presentation.

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