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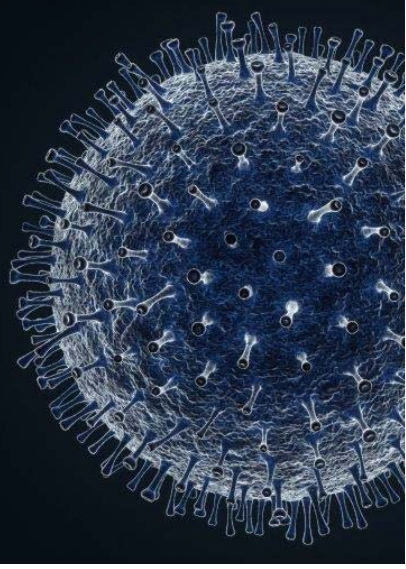
Accounting Implications of the Coronavirus



As the new Coronavirus (Covid-19) is spreading across the globe, companies need to make important operational decisions. But there is also the question about accounting: Is there an impact of the Coronavirus when preparing financial statements and interim reporting under IFRS? Let's have a closer look.

Who is impacted?
According to the OECD, the Coronavirus presents the global economy with its greatest danger since the financial crisis. Therefore, most companies may be affected, i.e. every company should make an assessment considering the individual facts and circumstances. Relevant questions include:

- Does the company directly or indirectly depend on supplies from affected regions?
- What is the impact on the sales side?
- What happens to the company's operations if employees are infected?
- How vulnerable is the company to market price fluctuations?
- What is the impact on the company's cash flows?

The answers to such questions will give a first indication of how severe and in which areas the impact on accounting could materialize.

Is the Coronavirus an adjusting or a non-adjusting event?

This depends on the reporting date:

- For the reporting date 31 December 2019, there is a broad consensus in the market that the Coronavirus is a non-adjusting event. Consequently, there is no impact on recognition and measurement of assets and liabilities. However, please have a look at the answers to the questions 'Are there any consequences from non-adjusting events?' and 'What about the going concern assumption? Does the concept of adjusting vs. non-adjusting event apply for this assumption as well?'.

- For reporting dates after 31 December 2019, more information was available that market participants will factor into their assumptions and assessments. Accordingly, we would expect an adjusting event for subsequent reporting dates. Adjusting events are taken into consideration in accounting, which means that any impact will have to be recognized in the financial statements.

If it is an adjusting event as of the reporting date, what could be impacted?
The economic consequences and uncertainties resulting from the Coronavirus itself or from actions taken by governments and the private sector to respond to the outbreak may for example have an impact on (non-exhaustive list):

- Assets and liabilities measured at fair value,
- Impairment of intangible and tangible assets,
- Net realizable value of inventory,
- Recoverability of deferred tax assets,
- Expected credit losses on financial assets,
- Classification of financial liabilities as current or non-current, and
- Classification as contingent liability.

Fair value measurement reflects the conditions as of the measurement date. This may be particularly challenging when fair value measurement is based on unobservable inputs and circumstances are changing rapidly.

The current situation may trigger an impairment testing, e.g. due to significant adverse changes in the company's market or mass cancellations of orders. In addition, the impairment test itself can be impacted as previous expectations about future cash flows may need to be updated.

There may be less demand for some goods, which in turn may create pressure on sales prices and / or result in less inventory turnover, thus leading to additional write-downs to net realizable value.

As the economic outlook deteriorates and the company's earnings decline, recoverability of any recognized deferred tax assets should be carefully verified.

Expected credit losses are based on information about past events, current conditions and the prediction of future economic conditions. Economic difficulties of customers and the negative economic outlook in general may require an increase in the provision for expected credit losses of financial assets.

If the financial situation of the company deteriorates, financial covenants may be triggered. As a consequence, the financial liabilities will become immediately repayable. If this cannot be remediated before the reporting date, classification of the respective financial liabilities as current liabilities is required, regardless of the remaining contractual term.

Liabilities previously meeting the definition of a contingent liability may need to be reconsidered and recognized on the balance sheet.

If it is a non-adjusting event as of the reporting date and the financial statements are prepared right now, is it possible to use hindsight?

No, the use of hindsight is generally not permitted. The financial statements should be based on the information that was reasonably available as of the reporting date. As such, only information that provides evidence of the conditions that existed at the end of the reporting period can be considered.

Are there any consequences from non-adjusting events?

Yes, material non-adjusting events are to be disclosed in the notes to the financial statements. This includes a description of the implications of the Coronavirus and any actions taken by governments and the private sector to respond to the outbreak that have an impact on the company's financial situation. If possible the financial effect should be disclosed.

For example, disclosure of estimated effects on impairments of financial and non-financial assets, covenant breaches, amendments, or waivers in lending agreements, losses due to supply chain issues, volatility in commodities or foreign currency exchange markets after the reporting date may be required. It may also be necessary to provide sensitivity information on possible value changes.

Non-adjusting events may also impact information provided in the management commentary (if the company prepares one).

What about the going concern assumption? Does the concept of adjusting vs. non-adjusting event apply for this assumption as well?

No, the concept of adjusting vs. non-adjusting event does not apply to the going concern assumption. Management needs to assess whether the current events and conditions cast significant doubt on the company's ability to continue as a going concern, or in severe cases, whether the going concern assumption is still appropriate as a basis for the preparation of the company's financial statements (or interim reporting).

If the conclusion is that the consequences of the Coronavirus outbreak have led to a deterioration of the financial situation after the reporting date that is so severe that the going concern basis of preparation is no longer considered appropriate, the financial statements (or interim reporting) would need to be adjusted. This will require application of the general measurement, recognition and disclosure requirements, with particular attention paid to the requirements for assets that are being held for sale, the classification of the company's debt and equity instruments, impairment testing and recognition and measurement of provisions.

To the extent that events and conditions are identified that may cast significant doubt on a company's ability to continue as a going concern, disclosure would be required if these events constitute material uncertainties or management's conclusion involves significant judgement.

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