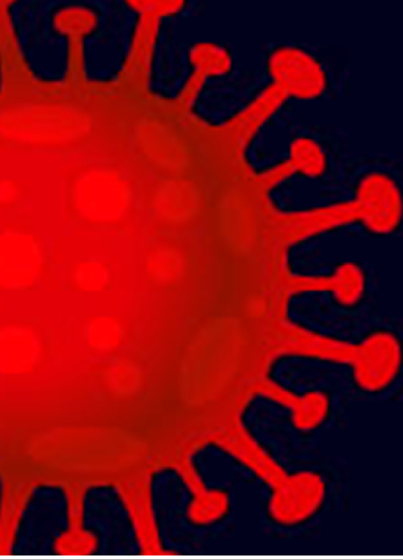

SEFTON FROSS

COVID - 19 SERIES

GUIDANCE FOR PREPARERS OF FINANCIAL STATEMENTS DURING THE COVID-19 PANDEMIC

ALERT | 12 MAY 2020

INTRODUCTION

To address the impact of the COVID-19 pandemic on the economy and to alleviate some of the unprecedented risks faced by companies, the Financial Reporting Council (FRC), on 22 April 2020, issued its "Guidance for Preparers of Financial Statements During COVID-19 Period" (COVID-19 Guidance) requiring all entities to assess whether and how they are being affected by the pandemic and its impact on their financial statements.

The purpose of the Covid-19 Guidance is to assist directors and management of companies with assessing the risk of the COVID-19 pandemic at an early stage of the financial reporting and audit process for any period ending on or after 1 January 2020; on or before December 2019; or any prior year's financial statements that are yet to be finalized. However, the COVID-19 Guidance does not impact on the requirements in the financial reporting standards.

Assessing the financial impact of the COVID-19 pandemic on business entities

While the impact of the COVID-19 pandemic may differ for each entity, under the COVID-19 Guidance, the preparers of financial statements are enjoined to adopt certain parameters in assessing the direct and indirect financial impacts of the pandemic on their businesses. Some of the parameters include but are not limited to:

- changes in expected credit losses for loans and other financial assets including updating the assumptions and macroeconomic factors applied;

- impairment testing of non-financial assets and changes in assumptions;
- changes in fair value of other financial and non-financial assets measured at fair value;
- net realizable value of inventory;
- increased costs and/or reduced demand requiring provisions for onerous contracts, reassessment of variable consideration, contingent liabilities, contingent assets, restructuring provisions reassessments; modification of loan contracts and lease contracts;
- the effect of government and regulatory relief programmes on both the company and customers;
- changes in employee benefits assumptions and planned assets; and
- effects on interim reporting in accordance with IAS 34.

Events after the reporting period

(a). In respect of periods ended on or before December 31, 2019, where the reporting period has already ended, the FRC supports the consensus that the outbreak of the COVID-19 pandemic in 2020 was a non-adjusting event for financial statements for the period ended 31 December 2019, it expects to see the effect of the outbreak in sub -sequent financial reports with post December 2019 reporting dates.

(b). Where the entity's reporting period has ended, and COVID-19 was assessed to be a non-adjusting event, the nature of the event and its likely impact should nonetheless be disclosed. Where an estimate of the financial effect on the company can be made, this should be disclosed or else the fact that the financial effect cannot be estimated should be disclosed. The estimate does not need to be exact – a range of estimated effects is better than no quantitative information at all. In the absence of any quantitative estimate, a qualitative description should be provided including the area of the financial information and sensitivities it is expected to have.

Preparers of financial statements should therefore consider what disclosures are necessary if the impact of the COVID-19 pandemic is material. The impact of COVID-19 would be material if:

(i). there is a material financial impact; or

(ii). users reasonably expect COVID-19 to impact their entity, regardless of whether there is a quantitative impact.

Preparers must consider relevant accounting standards to determine appropriate disclosures. Whether there is a financial impact or not, entities are required to disclose information about assumptions regarding the future and other key sources of estimation uncertainty and their key assumptions as to why it has not had an impact.

Going Concern and Group reporting

Entities are required to consider all relevant future information for at least, but not limited to, the twelve (12) months after reporting date when making the going concern assessment in accordance with IAS 1. The COVID-19 Guidance further directs that when management decides that it intends to liquidate or cease trading, or has no realistic alternative but to do so, either before or after the reporting period ends, the financial statements should no longer be prepared on a going concern basis. And to this extent, disclosures on material uncertainties that cast significant doubt on the ability to continue as a going concern such as the extent of the impact on future costs and revenues and unknown duration of the impact, must be made.

The COVID-19 Guidance allows preparers to consider the implications involved if entities cannot obtain information from subsidiaries, associates or joint ventures. Financial statements must present the financial position, financial performance and cash flows of the entities (group) fairly. Where subsidiaries, associates or joint ventures are material, all the available sources of the information necessary to prepare financial statements for the group should be considered.

Modification of financial instruments and calculation of expected credit losses in accordance with IFRS 9

The preparers of financial reports should carefully consider the related impact on financial reporting with respect to the requirements of IFRS 9. In assessing the impacts, the preparers must assess the specific conditions and circumstances that allow preparers to distinguish between measures that have an impact on the credit risk over the expected life of the financial assets and those which address temporary liquidity constraints of borrowers.

(a). **Accounting for the modifications resulting from the introduction of support measures**

Preparers should carefully assess the impact of the economic support and possible relief measures on recognised financial instruments and their conditions. The assessment is to determine whether such measures result in modification of the financial assets and liabilities as well as if the modifications lead to the financial assets' derecognition or whether it is just an adjustment through profit or loss statement.

(b). **Assessment of Significant Increase in Credit Risk (SICR)**

IFRS 9 requires preparers to assess at each reporting date whether the credit risk of a financial instrument has increased significantly since its initial recognition. The FRC notes that assessing whether there is a SICR is a holistic assessment of several quantitative and qualitative indicators and should capture the changes in the lifetime risk of default, i.e. over the entire expected life of the instrument. The FRC opines that, the various economic programmes established by the Nigerian Government for the COVID-19 impacted businesses are designed to lessen the adverse effects of COVID-19 and related economic consequences. When these support programmes impact (i.e. decrease) the lifetime risk of default on a financial instrument, they should be considered in the assessment of the SICR of that financial instrument. However, measures taken in the context of the COVID-19 pandemic which permit, encourage or require suspension or delays in payments, should not be regarded as automatically having a one-to-one impact on the assessment of whether loans have suffered a SICR.

(c). **Assessment of Significant Increase in Credit Risk (SICR)**

The Expected Credit Loss model in IFRS 9 requires preparers to measure expected losses and consider forward-looking information, by reflecting "an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes". Preparers are to consider "reasonable and supportable information that is available without undue cost or effort at that date about past events, current conditions and forecasts of future economic conditions". The FRC expects that when making forecasts preparers would consider the nature of this economic shock (i.e. whether the effect of the COVID-19 pandemic is expected to be temporary) and the impact that the economic support and relief measures (including debt moratoria) will have on the credit risk over the expected life of the instruments.

Conclusion

While no requirements in the financial reporting standards were altered, removed or added to, the COVID-19 Guidance, like guidelines issued by other regulatory agencies offers options for the mitigation of the adverse effects of the COVID-19 pandemic. It is our view that the COVID -19 Guidance will help preparers to prepare financial statements based on the effects of the COVID-19 pandemic without necessarily compromising the standards for the preparation of financial statements.

Click here for more legal resources on how COVID-19 affects you.

For more information, please contact us at: info@seftonfross.com:

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