

COVID-19 accounting implications for CFOs

Events after the reporting period

If the widespread impact of COVID-19 began during the entity's reporting period, the impact will be reflected in its financial statements for that period. However, to the extent that the widespread impact of COVID-19 occurred during the entity's 'subsequent events period' (ie the period between the end of the reporting period and the date when the financial statements are authorised for issue), management must determine how material developments after the year-end should be reflected in the entity's financial statements for the period under audit or review.

In accordance with IAS 10 'Events after the Reporting Period', entities are required to distinguish between subsequent events that are adjusting (ie those that provide further evidence of conditions that existed at the reporting date) and non-adjusting (ie those that are indicative of conditions that arose after the reporting date). Entities are required to update the carrying amounts of any assets or liabilities recognised in their financial statements to reflect any adjusting events that occur during the subsequent events period.



When does COVID-19 not become an adjusting event?

In our view, the impact of COVID-19 would be a non-adjusting subsequent event for reporting periods ended on or before 31 December 2019. Consequently, there would be no impact on the recognition and measurement of assets and liabilities in an entity's financial statements. Although cases of the virus in Wuhan City, China were reported to the World Health Organisation (WHO) on 31 December 2019, there was little confirmed evidence of human-to-human transmission at that time and the WHO did not declare the outbreak to be a public health emergency of international concern until 31 January 2020.

As such, it is presumed that the significant development and spread of COVID-19 did not take place until January 2020. Financial statements for an entity with a reporting period ending on or before 31 December 2019 should only reflect the conditions that existed at 31 December 2019 and must therefore exclude the significant effects of the COVID-19 pandemic.

However, all reporting entities should determine whether or not they should make additional disclosures to describe the impacts of the outbreak in the subsequent events period. Generally, disclosure should be made of those events during the subsequent events period that do not relate to conditions that existed at the date of the financial statements but cause significant changes to assets or liabilities in the subsequent period and either will, or may, have a significant effect on the future operations of the entity. For material non-adjusting events, IAS 10 stipulates an entity must disclose (a) a description of the nature of the event; and (b) an estimate of the financial effect, or a statement that such an estimate cannot be made.

Examples of non-adjusting events that would generally result in disclosure include:

- management's plans to deal with the effects of the COVID-19 outbreak and whether there is material uncertainty over the entity's ability to continue as a going concern
- breaches of covenants, waivers or modifications of contractual terms in lending arrangements
- supply chain disruptions
- the assessment of certain purchase or sale agreements as onerous contracts
- announcing a plan to discontinue an operation
- announcing, or commencing the implementation of, a major restructuring or downsizing (temporarily or permanently)
- declines in the fair value of investments held after the reporting period (eg pension plan investments)
- abnormally large changes in asset prices or foreign exchange rates, and
- entering into significant commitments or contingencies, such as issuing significant guarantees to related parties.

Example disclosures for non-adjusting events

All disclosures should be entity-specific and include information relevant to their circumstances. The following are some examples for some potential non-adjusting events for 31 December 2019 financial statements:

Overall risk to operations

Since 31 December 2019, the spread of COVID-19 has severely impacted many local economies around the globe. In many countries, businesses are being forced to cease or limit operations for long or indefinite periods of time. Measures taken to contain the spread of the virus, including travel bans, quarantines, social distancing, and closures of non-essential services have triggered significant disruptions to businesses worldwide, resulting in an economic slowdown. Global stock markets have also experienced great volatility and a significant weakening. Governments and central banks have responded with monetary and fiscal interventions to stabilise economic conditions. **[Add description specific to how the entity's financial position and performance has or is likely to be affected]**

The Company has determined that these events are non-adjusting subsequent events. Accordingly, the financial position and results of operations as of and for the year ended 31 December 2019 have not been adjusted to reflect their impact. The duration and impact of the COVID-19 pandemic, as well as the effectiveness of government and central bank responses, remains unclear at this time. It is not possible to reliably estimate the duration and severity of these consequences, as well as their impact on the financial position and results of the Company for future periods.

Note: this disclosure assumes there is no significant doubt about the entity's ability to continue as a going concern.

Store closures

On 27 March 2020, in response to significant decreases in demand resulting from social distancing efforts, quarantines and border closures related to the spread of COVID-19, the Company announced that it would temporarily close 30 of its 100 stores, which represented average monthly sales of approximately CU325,000 during the year ended 31 December 2019.

The closures are expected to reduce the following expenses by the following amounts on a monthly basis for at least the next six months : [insert specific line items and amounts in a table below]

The Company also announced that it would continue to pay its store associates for all scheduled shifts that were planned for the two-week period beginning on 27 March 2020. The salaries and benefits expense estimated for this two-week commitment is approximately CU50,000.

Workforce changes

During March 2020, in response to significant decreases in demand amidst the COVID-19 outbreak, the Group announced its intention to temporarily reduce its workforce by 130 positions by the end of April 2020, by means of either reduction in hours or temporary leave. The Group plans to continue providing health benefits for furloughed employees through to 30 June 2020. The Group expects the reduction in positions to reduce salaries and benefits expense in 2020 by a net amount between CU25,000 and CU20,000 per month. Other expected financial effects include... **[insert details]**

Customer defaults

Subsequent to 31 December 2019, one of the Company's major trade customers declared bankruptcy following severe decreases in sales as a result of the continued spread of COVID-19. Of the CU135,000 receivable from this customer, the Company expects to recover less than CU10,000. The allowance for expected credit losses for this receivable was CU5,000 as at 31 December 2019.

Decline in fair value of investments

Since 31 December 2019, the outbreak of COVID-19 and related global responses have caused material disruptions to businesses around the world, leading to an economic slowdown. Global equity markets have experienced significant volatility and weakness. As at 31 March 2020, the date that these financial statements were authorised for issue, the fair value of the Group's investments had declined significantly to the following amounts: **[insert figures here]**

While governments and central banks have reacted with monetary interventions designed to stabilise economic conditions, the duration and extent of the impact of the COVID-19 outbreak, as well as the effectiveness of government and central bank responses, remains unclear at this time.

These subsequent changes in the fair value of the Organization's investments are not reflected in the financial statements as at 31 December 2019.

“In our view, the impact of COVID-19 would a non-adjusting subsequent event for reporting periods ended on or before 31 December 2019.”

When would COVID-19 be considered an adjusting event?

Since late January 2020, the number of COVID-19 cases and countries affected outside of China grew rapidly, and on 11 March 2020, the WHO declared COVID-19 to be a global pandemic. During this period, governments and various private sector organisations took significant measures to contain the virus, including quarantines and school, store, plant and border closures. Consequences of the outbreak have also contributed to significant volatility in global stock markets since late February 2020.

Broadly speaking for reporting periods that ended on or after 31 January 2020, our view is that enough was known about the pandemic for preparers and market participants to reflect and, if necessary, adjust the assumptions and assessments. Furthermore, the later the annual reporting period is after this date [ie 31 March 2020, 30 June 2020 or 30 September 2020], the greater the number of COVID-19 related consequences have to be factored in to any adjusting event determinations and disclosures that are made.

Every reporting entity has to carefully consider the conditions and how they impact the reporting entity, because the same condition could impact entities differently for the same reporting date. IAS 10 makes it clear that management should consider the specific circumstances that relate to the entity's operations and the relevant events that existed in their jurisdiction at that time. It is appropriate for management to consider the following information which potentially became apparent subsequent to period-end when assessing the accuracy of their estimates and judgements made prior to the information becoming available:

- restrictions on domestic and international travel
- the economic consequences of social distancing resulting on capacity restrictions at events and hospitality locations
- forecasts potentially not being achieved due to market conditions
- cessation of non-essential services
- interruptions in supply of either goods or services
- customers entering administration, or
- government support.

Where this judgement has a significant impact on the amounts in the financial statements, it should be disclosed in accordance with IAS 1.

When it is determined that COVID-19 was an event that existed and caused an impact to operations at or before the reporting date, it should be accounted for as an adjusting event in compliance with IAS 10.

What is the impact of COVID-19 on 31 March 2020 reporting dates?

By the end of March 2020, it would be extremely difficult to say that the pandemic was not an event that existed and therefore any accounting impact that occurred after this date is not an adjusting event. This means all estimates and forecasts should include the expected impact of COVID-19, including:

- impairment of property, plant and equipment, intangibles, goodwill
- revenue recognition
- deferred taxes
- going concern
- expected credit losses
- inventory obsolescence.

Disclosing adjusting events

Based on guidance issued by some regulators, our recommendation is that reporting entities put all the matters relating to COVID-19 into one part of their financial statements and make sure that the matter of COVID 19 is prominently displayed.

Below is an extract from Macquarie Group Limited in Australia, who disclosed the COVID-19 impact in Note 1 of its 31 March 2020 consolidated financial statements.¹ Under the major note heading called 'Summary of Significant Accounting policies' it had a subheading addressing the entity's 'Basis of Preparation' and under that heading a further subheading to draw attention to the impact of COVID-19 on the consolidated entity's financial statements.

Note 41 – Coronavirus (COVID-19) impact

Background

COVID-19, which is a respiratory illness caused by a new virus, was declared a world-wide pandemic by the World Health Organisation in March 2020. COVID-19, as well as measures to slow the spread of the virus, have since had a significant impact on global economies and equity, debt and commodity markets. The Consolidated Entity has considered the impact of COVID-19 and other market volatility in preparing its financial statements.

While the specific areas of judgement as noted on the previous page did not change, the impact of COVID-19 resulted in the application of further judgement within those identified areas. Given the dynamic and evolving nature of COVID-19, limited recent experience of the economic and financial impacts of such a pandemic, and the short duration between the declaration of the pandemic and the preparation of these financial statements, changes to the estimates and outcomes that have been applied in the measurement of the Consolidated Entity's assets and liabilities may arise in the future. Other than adjusting events that provide evidence of conditions that existed at the end of the reporting period, the impact of events that arise after the reporting period will be accounted for in future reporting periods.

Impact of COVID 19 on the macro economic outlook

Forward-looking information, including a detailed explanation of the scenarios and related probabilities considered in determining the Consolidated Entity's forward-looking assumptions for the purposes of its expected credit loss (ECL), has been provided in Note 12 to the financial statements. Noting the wide range of possible scenarios and macroeconomic outcomes, and the relative uncertainty of how COVID-19 and its social and economic consequences will flow, these scenarios represent reasonable and supportable forward-looking views as at the reporting date.

Processes applied

As a consequence of COVID-19 and in preparing these financial statements, management:

- re-evaluated whether there were any additional areas of judgement or estimation uncertainty beyond what has been disclosed above
- updated its economic outlook – principally for the purposes of inputs into its ECL through the application of forward looking information, but also for input into the impairment analysis of financial and non-financial asset classes and disclosures such as fair value disclosures of financial assets and liabilities
- reviewed external market communications to identify other COVID-19 related impacts
- reviewed public forecasts and experience from previous downturns
- conducted several internal processes to ensure consistency in the application of the expected impact of COVID-19 across all asset classes
- assessed the carrying values of its assets and liabilities and determined the impact thereon as a result of market inputs and variables impacted by COVID-19

¹ For complete details of the financial statements that were approved for issue in 8 May 2020 please refer to: <https://www.macquarie.com/au/en/investors/reports/full-year-2020.html>

- ran multiple stress testing scenarios, which are an integral component of Consolidated Entity's risk management framework and a key input to the capital adequacy assessment process, to assess the potential impacts of the COVID-19 pandemic on its portfolio to assist in the organisation's prudent risk management, and
- considered the impact of COVID-19 on the Consolidated Entity's financial statement disclosures.

Consideration of the statements of financial position and further disclosures

Key statements of financial position sheet items and related disclosures that have been impacted by COVID-19 were as follows:

Trading assets, trading liabilities and financial investments

Given recent market volatility, the Consolidated Entity reviewed the appropriateness of the inputs to its valuations, which included the use of correlations, price volatilities, funding costs and bid offer, counterparty and own credit spreads. The impact of changes in valuation inputs has also been considered in terms of the classification of exposures in the fair value hierarchy, transfers within the fair value hierarchy and the Level 3 sensitivity analysis. The Consolidated Entity's financial investments include a portfolio of unlisted equity investments which, in accordance with the Consolidated Entity's accounting policies, are measured at FVTPL. The determination of the investments' carrying value included a consideration of the impact of COVID-19.

Derivative assets and liabilities

Given recent market volatility, the Consolidated Entity reviewed the appropriateness of the inputs to its valuations. These included valuation adjustments (XVA) and notably the credit valuation adjustment (CVA), debit valuation adjustment (DVA) and funding valuation adjustment (FVA). The impact of changes of inputs to the valuations has also been considered in terms of the classification of exposures in the fair value hierarchy and transfers within the fair value hierarchy.

Held for sale assets and liabilities

Held for sale assets and liabilities includes certain disposal groups and investments in associates and joint ventures for which the conditions precedent relating to the disposal were met subsequent to 31 March 2020. For these and other items that are classified as held for sale, the appropriateness of the held for sale classification at the reporting date was reassessed and affirmed. Further, the impact of COVID-19 on the carrying value of the assets and liabilities that were classified as held for sale was assessed. Refer to Note 10² and Note 21.²

Loan assets, due from subsidiaries and other assets

In response to COVID-19 the Consolidated Entity and the Company undertook a review of wholesale and retail credit portfolios, loans to its subsidiaries and other financial asset exposures, as applicable, and the ECL for each. The review considered the macroeconomic outlook, customer credit quality, the type of collateral held, exposure at default, and the effect of payment deferral options as at the reporting date. The ECL methodology, SICR thresholds, and definition of default remained consistent with prior periods. The model inputs, including forward-looking information, scenarios and associated weightings, together with the determination of the staging of exposures were however revised. The impact of COVID-19 on the credit risk management disclosures, notably in relation to credit quality and collateral and other credit enhancements was also considered. Refer to Note 12² and Note 34.²

Property, plant and equipment and right-of-use assets

Included in the group's property, plant and equipment and right-of-use assets at 31 March 2020 is a portfolio of rotorcraft assets. Given the impact of COVID-19, the portfolio was subject to impairment testing which concluded that no material impairment was required. Refer to Note 13.²

Interest in associates and joint ventures, investments in subsidiaries and interests in unconsolidated structured entities

The Consolidated Entity's investments in associates and joint ventures is diversified, has been acquired over time and covers various sectors (including infrastructure and green energy) and geographic locations. When it has been assessed that there is an indicator of impairment the Consolidated Entity tests the carrying amount of each of its investments for impairment, by comparing the investment's recoverable amount with its carrying value. Disclosures with respect to the Consolidated Entity's equity accounted interests in Macquarie AirFinance Limited, East Anglia ONE Limited and Macquarie Infrastructure Corporation (MIC) have been provided. In addition to the Company assessing its investments in subsidiaries for impairment, the Company and Consolidated Entity re-affirmed that there were no circumstances as a result of COVID-19 that would affect the existing control conclusion for its subsidiaries, including structured entities, nor did it highlight instances in which the Company or Consolidated Entity now had control of such entities. Refer to Note 14² and Note 16.²

² Not reproduced

Intangible assets

Consistent with the Consolidated Entity's accounting policies, the Consolidated Entity has tested goodwill and indefinite life intangible assets for impairment and has reviewed the carrying value of its finite life intangible assets at the reporting date for indicators of impairment and, where applicable, reviewed the measurement of the carrying value of such intangible assets. Such assessment incorporated a consideration of COVID-19. Refer to Note 15.³

Debt issued and loan capital

Debt-related covenants were assessed to determine whether there were any breaches for which disclosure is required. The Consolidated Entity identified no such breaches at 31 March 2020 nor at the time at which these financial statements were authorised for issue. Refer to Note 22³ and Note 24.³

Hedge accounting

An assessment was conducted as to the impact of COVID-19 with respect to whether the hedged forecasted cash flows in cash flow hedge relationships remain highly probable at the balance date. Based on available facts as at 31 March 2020, including announcements from governments and regulators, as well as discussions with our clients, the modelling of the hedged future cash flows were determined to remain highly probable and hence hedge accounting has continued to be applied.

Risk management

The Consolidated Entity's robust risk management framework continues to be applied across the Operating and Central service groups and RMG continues to monitor the impact of COVID-19 on the Consolidated Entity's risk profile. Non-financial risks emerging from global movement restrictions, and remote working by our staff, counterparties, clients and suppliers, are being identified, assessed, managed and governed through timely application of the Consolidated Entity's risk management framework.

This accounting policy note sends the readers of these financial statements to ten other detailed notes within its consolidated financial statements, therefore illustrating that for this Australian financial institution multiple financial statement areas have been impacted by the pandemic.

To make it clear to the readers of their consolidated financial statements there were not any other material matters that needed to be disclosed, Macquarie made the following disclosure in its final note of its 31 March 2020 consolidated financial statements:

Note 50 – Events after the reporting date

There were no material events subsequent to 31 March 2020 and up until the authorisation of the financial statements for issue, that have not been disclosed elsewhere in the financial statements.

How Grant Thornton can help

Preparers of financial statements will need to be agile and responsive as the situation unfolds. Having access to experts, insights and accurate information as quickly as possible is critical – but your resources may be stretched at this time. We can support you as you navigate through accounting for the impacts of COVID-19 on your business.

Now more than ever the need for businesses, their auditor and any other accounting advisors to work closely together is essential. If you would like to discuss any of the points raised, please speak to your usual Grant Thornton contact or visit www.grantthornton.global/locations to find your local member firm.

³ Not reproduced