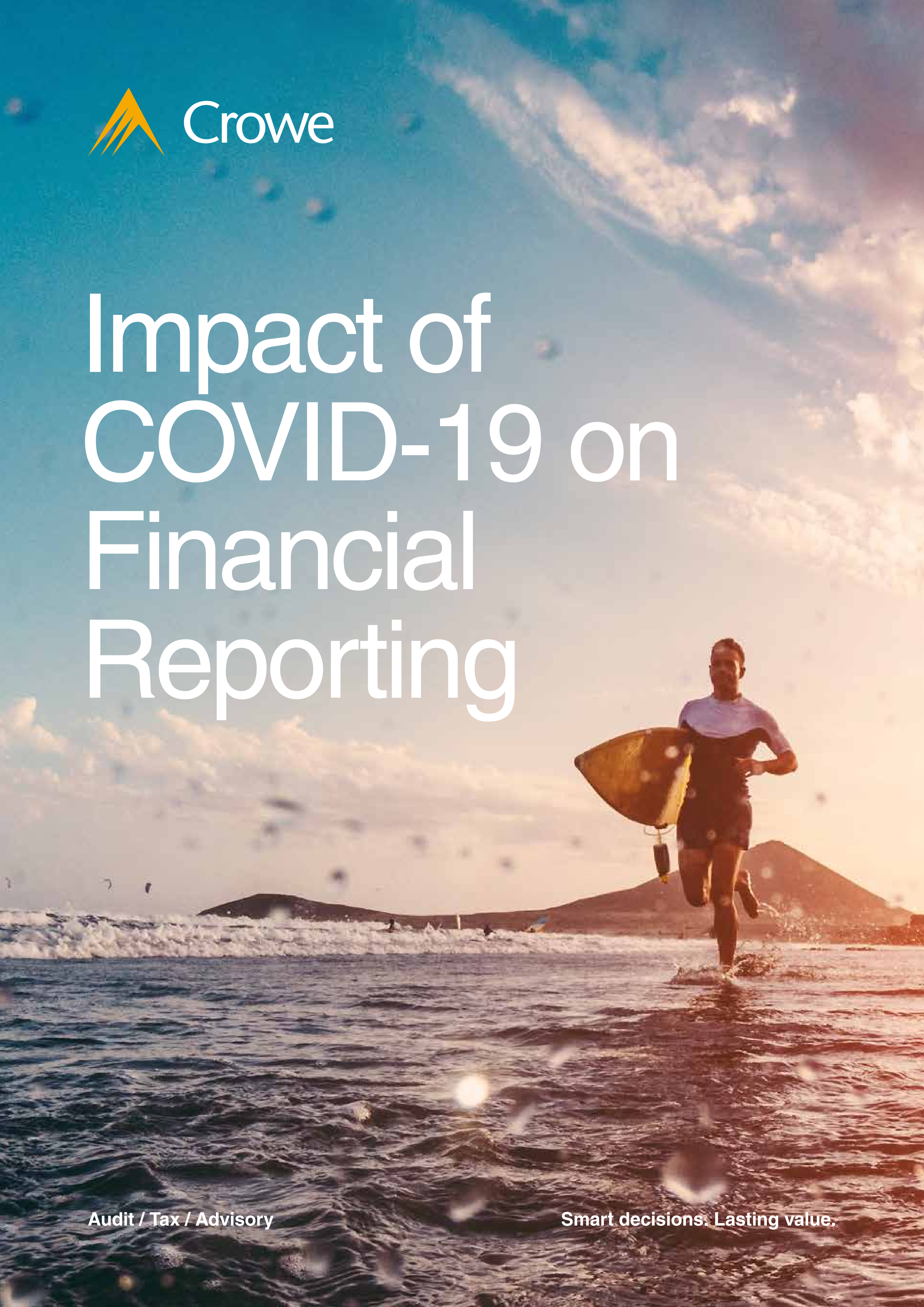

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Impact of COVID-19 on Financial Reporting

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Introduction

The evolving coronavirus disease (COVID-19) pandemic has directly affected the global economies and the daily lives of every member of the global community.

The Singapore Exchange has announced on 7 February 2020 that companies with their principal place of business in the People's Republic of China ("PRC") or have business with significant operations in the PRC, will have up to 30 June 2020 to hold their AGMs. This was in response to feedback from audit professionals about their practical difficulties in performing the statutory audits for certain affected companies. On 27 February 2020, this waiver was further extended to all companies with a 31 December financial year-end.

In this article, we seek to highlight the impact of COVID-19 on financial reporting and enable Directors and those charged with governance ("TCWG") to focus on key responses as they continue to discharge their financial reporting responsibilities.

The Effect on Financial Reporting

The business operations of certain industries such as airlines, tourism & hospitality and retail have been directly impacted by the travel restrictions and social distancing requirements. Business operations have also been significantly affected for many companies, including those heavily reliant on human resources from foreign countries and those with multi-location operations in more than one country and particularly in countries where the COVID-19 outbreak has been most widespread and severe.

It is expected that many companies would report a lower revenue for the financial year 2020, and some would need to record fair value losses or impairment losses on their investments. Directors and/or TCWG of listed entities would have to consider the need to provide profit guidance and warnings to users and investors in due course.

We highlight certain specific considerations[1] of the Financial Reporting Standards in Singapore[2] (FRSs) as follows:

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[1]Please note that we do not warrant to present a complete list of considerations in this document as it is impossible to do so since every entity would have its specific or peculiar circumstances. Please contact your usual client service partners or managers, and we would be pleased to discuss in greater detail with you.

[2]Listed entities may refer to the equivalent in Singapore Financial Reporting Standards (International).

- **Going Concern (FRS 1 *Presentation of Financial Statements* and FRS 10 *Events after the Reporting Period*)**

  An entity shall not prepare its financial statements on a going concern basis if management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so. When making assessment on the ability of the entities to continue as a going concern, entities should take into account all available information about the future obtained after the reporting date and continuously update the assessment up to the date of authorisation of the financial statements. In assessing the impact, entities should consider:

  – Impact of travel restrictions and social distancing requirements on operations and revenue generating activities
  – Availability of government aids and assistance
  – Existing financial resources including sources of financial support
  – Financial health of key suppliers and customers
  – Period over which the conditions continue or deteriorate

  When entities conclude that going concern basis of accounting is appropriate, disclosures may be required to bring to the users' attention on the existence of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern and the judgment management made in arriving at the conclusion.

- **Adjusting or Non-Adjustment Events (FRS 10 *Events after the Reporting Period*)**

  Management will be confronted with the fundamental question as to whether to treat the COVID-19 pandemic as an adjusting or non-adjusting event, in accordance with FRS 10. Even though the transmission of the virus to humans started in late 2019 with cases of pneumonia of unknown origins in China, it was widely unknown to the rest of the world until the WHO declared the outbreak a "Public Health Emergency of International Concern" at the end of January 2020.

  In respect of 31 December 2019 year end, entities could make a judgement to determine whether the event that impacted the financial performance was a result of the economic conditions caused by government measures and market sentiment in response to the widespread transmission of the virus that occurred after the reporting date.

  Even though the financial effects would not be adjusting to the 31 December 2019 financial statements, companies are required to make disclosure of the impact if its material, for example:

  – Economic conditions may impact impairment evaluations and fair-value measurements of financial and non-financial assets and liabilities
  – Expected impact on deterioration in credit risk of customers
  – Impact to lending arrangement, for example covenant breaches, amendments, or waivers by lenders
  – Potential inventory write-downs

- **Other Impact on the Statement of Financial Position:**
  - **Impairment of Non-Financial Assets (FRS 36 *Impairment of Assets*)**

    For 31 December 2019 impairment testing, entities should use assumptions that reflected the conditions existing as at that date. However, the forecasted cash flows should reflect management's best estimate of the economic conditions that will exist over the remaining useful life of the assets. For more recent financial period, it is expected that the current economic conditions would likely trigger an impairment indicator, and hence require impairment testing for more entities.

  - **Impairment of Financial Assets - Expected Credit Losses ("ECL") (FRS 109 *Financial Instruments*)**

    ECL is a probability-weighted measure and does need to take into account forecast of future economic conditions that is based on reasonable and supportable information which is reasonably available at the reporting date. If it is assessed that the probability of the virus becoming a pandemic with far-reaching adverse impact on global economy as remote based on information available as at 31 December 2019, then the COVID-19 situation would not practically have an impact on ECL assessment performed on that date.

  - **Fair Value Measurements (FRS 113)**

    Entities may need to determine fair value of its assets on recurring basis or consider fair value in its impairment testing under FRS 36. Fair value measurement should reflect the market participants' expectations at the measurement date. Hence, adverse impact from subsequent development of the pandemic after 31 December 2019 is not expected to impact fair value measurement as at that date base on the information available then about COVID-19. Entities should take note of FRS 1 requirements to disclose of assumptions it makes about the future and the estimation uncertainty at reporting date with significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. This would be required unless the fair value is based on a quoted price in an active market for an identical asset or liability.

  - **Determination of Net Realisable Value (FRS 2 *Inventories*)**

    It is expected that the financial statements after 31 December 2019 would need to reflect the impact of economic conditions on the net realisable value of its inventories for the affected companies.

  - **Provisions for Contingencies or Onerous Contracts (FRS 37 *Provisions, Contingent Liabilities and Contingent Assets*)**

    Entities need to consider the impact of worsening of economic conditions on provisions, for example, in determining whether there is an onerous contract, or determining probability of the cash outflows. This may result in provisioning to be made on balance sheet, or at least, more extensive disclosure about the related judgement and estimation uncertainty.

  - **Recognition of Deferred Tax Assets (FRS 12 *Income Taxes*)**

    Entities may have recognised deferred tax assets on unused tax losses on the basis of expected future taxable profits. The amounts and availability of future tax profits may need to be adjusted in line with the current economic conditions. This may affect the recognition of deferred tax assets.

– **Recognition of Variable Consideration or Refund Liabilities for Contracts with Customers (FRS 115 *Revenue from Contracts with Customers*)**

  FRS 115 requires entities to estimate variable consideration or defer certain portion of receipts to refund liabilities when appropriate. When making such estimation, entities are reminded to take into account the economic conditions and expectations as at the reporting date.

– **Disclosure of Risks Arising from Financial Instruments (FRS 107 *Financial Instruments: Disclosure*)**

  In view of the current economic conditions, entities should consider making extensive disclosure on how they are managing market risks, liquidity risks and credit risks. For example, entities may consider the disclosure of sensitivity analysis of equity price risks or interest rate risks based on the extent of subsequent fluctuations of the index or interest rates.

Concluding Remarks

As the extent of the impact varies from entities to entities, management is advised to assess based on the specific circumstances relevant to the entities and include qualitative disclosures that are customised to the pertinent risk factors.

In addition, in a group audit situation where the audit evidence obtained by component auditors in the respective countries where the group operates could be delayed, the consolidated financial reporting will be similarly affected. The Institute of Singapore Chartered Accountants ("ISCA") has published an Audit Guidance Statement (AGS) 12 *Group Audits - Inaccessibility of Component Auditors' Work Papers and Other Considerations*, to provide guidance to group auditors who may require longer time or alternative means to finalise the audits of consolidated financial statements. Directors and TCWG can expect significant challenges in finalising the audited financial statements and the accompanying auditors' report. Early engagement with auditors, along with continuous and timely discussion is therefore strongly recommended.

Contact Information
Angeline Tan, Head of Audit
angeline.tan@crowe.sg

Crowe Horwath First Trust LLP
8 Shenton Way
#05-01 AXA Tower
Singapore 068811

Tel: +65 6221 0338

For more information,
scan QR code below:

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