Crowe

COVID-19

Advice and guidance on the accounting and financial reporting requirements

Audit / Tax / Advisory

Smart decisions. Lasting value.

In December 2019, a novel strain of coronavirus (COVID-19) surfaced and spread around the world, with resulting business and social disruption. The coronavirus was declared a Public Health Emergency of International Concern by the World Health Organization on January 30, 2020. The coronavirus outbreak is dynamic and wide-ranging with known and potentially as yet, unknown impacts. There have been and continues to be significant market impacts caused by COVID-19. The COVID-19 pandemic crisis and its economic effects mean that investors and other stakeholders need high-quality financial information more than ever.

As the board and management of your business entity, you are responsible for ensuring that reporting requirements are met to identify the potential effects of the pandemic on the business and ultimately on what we report. To this end, Crowe has made available, advice and guidance on the accounting and financial reporting requirements that will need to be considered in addressing the financial effects of COVID-19 when preparing your financial statements.

The reference material in this document is intended to facilitate this discussion and assessment; however, you should include any other items you identify as related to this matter. This guidance document is not intended to address any management or risk reporting although certain aspects have been included, where they might impact assessments made management.

General Implications

Given the unprecedented and dynamic nature of COVID-19 and its increasingly broad global implications, the complete financial impact COVID-19 may have on an entity's business and operations will continue to evolve over time. This section of document addresses potential general implications to your business operations. The intention is to try and quantify the effects so as to be able to ascertain how your business will be positively or negatively affected.

1) **Interruptions of production or service:**
   - Please quantify where appropriate how interruptions will affect production or the provision of the services you provide to your clients. Examples include:
     - *Have you lost production hours?*
     - *What is the Impact on inventory quantities?*
     - *Is the inventory still in a saleable condition or you will have to provide discounts or write it off?*
2) **Supply chain disruptions:**
   - This addresses how stakeholders within your supply chain has been affected. What is the effect on suppliers and customers? Consider:
     - *Effect of current purchase or sales orders*
     - *Delivery of current orders to clients*
     - *Impact on pricing (have you offered discounts or incentives?)*
3) **Unavailability of personnel:**
   - Have there been any personnel affected?
   - Can you document how that has impacted operations where applicable?
   - Are there any wage earners (differentiate between variable and fixed costs)?
   - Have there been any key personnel affected and are not available? (specially trained staff)

4) **Reductions in sales, earnings, or productivity:**
    - Quantify this insofar as possible if projections are supportable. Are you able to establish lost sales per month?
    - Perform stress tests where assumptions of income are at zero with the corresponding adjustment of any variable costs. Provide a detailed analysis of your normal expenditures.
    - This should be ideally for a minimum of 3 months.

5) **Loss of key customers:**
    - Using previous data, quantify on a monthly, quarterly, bi-annual and annual basis, the sales made to key customers.
    - Contact your key customers and establish if and when they will be able to resume their operations and factor this into your projections.

6) **Closure of facilities, branches, subsidiaries or stores:**
    - Calculate and extrapolate the effect of closures where there are branches affected.
    - Consider the effect of subsidiaries that provide essential services and the effect of the group where applicable.
        - *Considerations should include the cost of compliance, e.g. if modifications to equipment is required or if new sanitising equipment has to be purchased.*

7) **Global market impacts:**
    - What interventions are available from SARS, the South African Government and Banking Institutions?

Accounting (and Disclosure) Implications

8) **Asset impairments – including goodwill, intangible assets, and other long-lived assets:**
   - Consider effects from stress-tests and cash flow projections and how they would affect computations for impairments where assets are not being fully utilized to their full capacity.
   - What are the leasing considerations for lessees (i.e. impairment of right of use assets, temporary relief provided by lessors)?
   - Check lease agreements and possible liabilities arising from a breach of contract terms.

9) **Deferred tax asset valuations:**
   - Is there a possibility that these will have to be ring-fenced as they might not be recoverable?

10) **Going concern Assessments:**
    The Financial Reporting Council has predicted that it is likely that more companies will disclose "material uncertainties" to going concern in the current circumstances. This term may not be widely understood. It refers to uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. In other words, if you identify possible events or scenarios (other than those with a remote probability of occurring) that could lead to business failure, then these should be disclosed in the financial statements.

    When identifying such events or scenarios, boards may take account of **realistically** possible mitigating responses open to them. These assessments are significantly more difficult currently given the uncertainties about the impact of COVID-19, the extent and duration of social distancing measures, the impact on the economy and asset prices generally.

- Perform stress tests assuming zero income/revenues (a stress test is similar to a sensitivity analysis).
- Adjust all expenditures where applicable. Some expenses will be impacted by low usage.
- Try and ascertain when the business will collapse without funding.
- If funding or tax concessions are available, factor it in your calculations.
- All information used in the assessment should be verifiable, e.g., if your bank has agreed to grant you a payment holiday, get that in writing. If the Landlord has agreed to delay the rent collection, get a formal letter.

11) **Loss contingencies:**
   - What is the proposed business strategy where losses are expected?
   - How will the business recover? Is there a Disaster Recovery Plan?
   - Review debt covenants/agreements and see if there are penalties for late payments and disclose these where necessary.

12) **Financial guarantees**:
   - Review debt covenants/agreements and see if there are penalties for late payments and disclose these where necessary.

13) **Valuation of investments:**
   - Consider if investments in subsidiaries, shares, etc., are not impaired? How are the investments performing in the current climate?
   - If significant investments have been made consider using an expert to perform the necessary valuations if they are complex.
   - Have dividends been declared?
   - Are you able to provide additional financial support for the investments as a shareholder? (consider group sub-ordinations)

14) **Collectability and valuation of receivables and loans:**
- Consider changes to allowances or provisions for expected credit losses on trade debtors and receivables.
- Consider the basis of any inputs and use of assumptions and estimation methods or techniques and ensure that these are supported by verifiable data or information where possible.

15) **Inventory impairments:**
- Consider inventories with expiry dates (especially for non-essential items).

16) **Other fair value measurements:**
- A change in the fair value measurement affects the disclosures as per the requirements in IFRS 13.
- Disclose the valuation techniques and the inputs used as well as the sensitivity of the valuation to changes in management's assumptions.
- Consider conditions and the corresponding assumptions known or knowable to market participants at the reporting date.

17) **Derivative and hedging issues:**
- Consider hedge accounting requirements in respect of derivatives for which the expected transaction is no longer highly probable or expected to occur.
- Inspect contracts and consider obtaining specialist advice where necessary.

18) **Revenue recognition:**
- Consider IFRS 15 Implications arising from COVID-19.
- Customers may not be able to meet the stated terms of their contracts which will result in a change in the timing and amount of revenue to be recognized.

- Should you stop recognizing revenue for existing contracts and not recognize revenue for new contracts where customers are no longer able to meet their contractual obligations?
- How should your account for contract modifications at client requests and what are the implications on revenue recognition?
- Rights to payment for performance to date may not be enforceable. Does this affect whether revenue can be recognized over time?

19) **Idle capacity and vacant facilities:**

- Consider impairment of property plant and equipment.

20) **Compensation matters (i.e. stock compensation, defined benefit obligations, employment termination):**

- What is the effect of any Service Level Agreements deviations?
- Are retrenchments supportable from a working capital point of view?
- Revenue contracts containing penalties for late or non-delivery. (consider effect of “force majeure”).
- Increased costs of fulfilling a customer contract due to the replacement of infected staff.
- Purchasing alternative raw materials at a higher price due to pressure on resources.
- Effect on the delivery of services in the education or tourism sectors which oblige entities to provide services or possibly refund despite expenditures made.

21) **Events after reporting date:**

- Have you evaluated (on paper) the effect of COVID-19 on your business continuity and response plan?
- More emphasis of this assessment will be required on year ends from February going forward.
- Judgements on Events after Reporting Date are highly dependent on the reporting date and the specific facts and circumstances of each company’s operations and value chain.

- Management may need to continually review and update the assessments up to the date the financial statements are issued given the fluid nature of the crisis and the uncertainties involved

Other Operational Implications

Assessing management's ability to complete its financial reporting process is imperative. This may be due to travel restrictions, access to personnel, or other operational matters.

- Consider the impact of COVID-19 on your board and management's ability to complete its financial reporting process
- Where applicable, consider any changes to your internal control environment. Are you able to ensure that misstatements/errors can be prevented or detected and corrected in time?
- Consider business risks and where possible update your risk register with new risks, controls and potential consequences.
- Will your personnel be accessible to auditors? Are they able to connect via email and/or video conferencing? Do you have capacity to share information via the cloud where there are large files to be transmitted or shared?
- Discuss any potential implications for meeting AFS reporting deadlines including any non-compliance to laws and regulations e.g. Companies Act.

Contact

Crowe JHB
3 Sandown Valley Crescent,
Sandown,
Johannesburg, 2196
Main 011 217 8000
info@crowe.za.com

Crowe HZK
7th Floor, 5 St. Georges,
St. Georges Mall,
Cape Town, 8001
Main 021 481 7000
hzk@crowe.za.com

About Crowe Global

Ranked eighth largest accounting network in the world, Crowe Global has over 200 independent accounting and advisory firms in 130 countries. For almost 100 years, Crowe has made smart decisions for multinational clients working across borders. Our leaders work with governments, regulatory bodies and industry groups to shape the future of the profession worldwide. Their exceptional knowledge of business, local laws and customs provide lasting value to clients undertaking international projects.