

Coronavirus outbreak – Potential financial reporting impacts

Reporting Update

24 February 2020, 20RU-003



Highlights

- Coronavirus background
- Is the Coronavirus outbreak an adjusting subsequent event for reporting periods ended 31 December 2019?
- Going concern
- Are any disclosures of non-adjusting subsequent events required for reporting periods ended 31 December 2019?
- How does the Coronavirus outbreak affect reporting periods ending after 31 December 2019?

Coronavirus background

What is the issue?

The Coronavirus outbreak started in Wuhan, China and was first reported on 30 December 2019. The responses by various governments and international organisations which highlighted the severity of the outbreak occurred after 31 December 2019. Some of the responses included the following:

- 22 January 2020: China quarantines the city of Wuhan
- 30 January 2020: The World Health Organisation (WHO) declares a public health emergency of international concern over the outbreak
- 1 February 2020: Australia's Department of Health advises against all travel to mainland China. Entry to Australia from mainland China is denied to all except Australian citizens, permanent residents, their immediate families and air crews. Those permitted entry are required to self-isolate for 14 days.

Various accounting estimates, which depend on future forecasts, could be impacted by the Coronavirus outbreak such as the carrying value of goodwill and the measurement of expected credit losses.

Coronavirus could impact accounting estimates

Implications on financial reports

Is the Coronavirus outbreak an adjusting subsequent event for reporting periods ended 31 December 2019?

Although the Coronavirus existed at 31 December 2019, it is the severity of the virus and the responses to the outbreak which may have an impact on an entity's operations.

These events arose after the reporting period, as such the outbreak is a non-adjusting event for the reporting period ending 31 December 2019 and no adjustment needs to be made to amounts recognised in the 31 December 2019 financial statements.

Going concern

When assessing whether an entity is a going concern, all relevant information available up to the date the financial statements are issued must be considered. Events that occurred after the reporting date to respond to the outbreak could have caused a significant deterioration in economic conditions for some entities, and an increase in economic uncertainty for others.

Management may need to assess whether these events or conditions, individually or collectively, cast significant doubt on the entity'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 entity's financial statements. If the conclusion is that the consequences of the outbreak have led to a deterioration in operating results and/or financial position after the reporting date that is so severe that the going concern basis of preparation is no longer considered appropriate, the financial statements as at 31 December 2019 would need to be adjusted.

Are any disclosures of non-adjusting subsequent events required for reporting periods ended 31 December 2019?

Entities consider whether the non-adjusting events or conditions related to the Coronavirus arising after the reporting date may be material. If material, an entity **discloses** the nature of the event and an estimate of its financial effect or a statement that an estimate cannot be made in its 31 December 2019 financial report. Non-adjusting events after the reporting period are material if non-disclosure could influence the economic decisions that users make using the financial statements.

How does the Coronavirus outbreak affect reporting periods ending after 31 December 2019?

Various estimates, which depend on future forecasts, could be impacted.

Examples of specific areas that may be impacted include:

Impairment of non-current assets and goodwill

- The outbreak may be an impairment trigger, resulting in more impairment tests and more impairments being recognised.
- The increase uncertainties inherent in the cash flows may be reflected by either adjusting the cash flows or the discount rate.

Will not impact recognition and measurement at 31 December 2019 unless it affects the going concern assumption

Disclosures may be required in financial reports for periods ended 31 December 2019

Significant judgement may be involved in reflecting the impact of Coronavirus in accounting estimates going forward

Onerous contract provisions

- Customer contracts may become onerous if, for example, suppliers are unable to fulfil their obligations under the contract as a result of closure or reduced production by manufacturing plants in China.
- The existence and enforceability of force majeure clauses in contracts may impact the assessment of whether contracts are onerous.

Net realisable value of inventory

- Net realisable value (NRV) of inventory may decrease if, for example, there is a reduction in demand for goods with short shelf lives.
- Sales and purchase contracts may be unable to be fulfilled resulting in excess inventory, in turn affecting NRV.

Expected credit losses

- Expected credit losses (ECLs) may increase.
- ECLs should reflect all reasonable and supportable information about the outbreak that are available up to the reporting date.
- No adjustment for new information received after the reporting date would usually be appropriate unless the new information indicates that there was a failure to consider appropriately all reasonably available information at the reporting date.

Deferred tax assets

- The recoverability of deferred tax assets may be impacted by changes to future forecasts.

Cash flow hedge accounting

- The determination of whether forecast transactions such as foreign currency cash flows are highly probable may be affected. For example, the closure of manufacturing plants in China may affect the assessment of whether sales or purchases are highly probable.
- The impact of such uncertainty on foreign currency cash flows could render the hedges as ineffective, resulting in the derivatives hedging instruments being fair value through the profit and loss.

Significant judgement and estimates disclosures

Disclosure will be important for entities with exposure to Coronavirus related uncertainties as the impacts involve significant judgement. Relevant disclosures include:

- Identifying key assumptions made about the impact of Coronavirus on material estimates
- Highlighting sources of estimation uncertainty that could result in material adjustments to the carrying amount of assets and liabilities, including sensitivity analysis or a range of outcomes.

“The potential impacts of Coronavirus continue to evolve. We encourage impacted entities to monitor the situation and maintain close communications with key stakeholders. Changes in circumstances may require additional or enhanced disclosures in financial reports.”

Patricia Stebbens

Partner, Department of Professional Practice

Further information

If your entity is potentially affected by Coronavirus and you would like to discuss further, please reach out to your usual KPMG contact.

More detail...

Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorised for issue. Two types of events can be identified:

- (a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and
- (b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period). [AASB 110.3]

An entity shall not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the reporting period. [AASB 110.10]

If non-adjusting events after the reporting period are material, non-disclosure could influence the economic decisions that users make on the basis of the financial statements. Accordingly, an entity shall disclose the following for each material category of non-adjusting event after the reporting period:

- (a) the nature of the event; and
- (b) an estimate of its financial effect, or a statement that such an estimate cannot be made. [AASB 110.21]

AASB 101.26 requires an entity to take all available information about the future into account when preparing its going concern assessment.

20RU-003 Coronavirus outbreak – Potential financial reporting impacts

The information contained in this document is of a general nature and is not intended to address the objectives, financial situation or needs of any particular individual or entity. It is provided for information purposes only and does not constitute, nor should it be regarded in any manner whatsoever, as advice and is not intended to influence a person in making a decision, including, if applicable, in relation to any financial product or an interest in a financial product. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

To the extent permissible by law, KPMG and its associated entities shall not be liable for any errors, omissions, defects or misrepresentations in the information or for any loss or damage suffered by persons who use or rely on such information (including for reasons of negligence, negligent misstatement or otherwise).