P&A Grant Thornton
An instinct for growth™

Accounting Alert

Financial Reporting

March 31, 2020

COVID-19 outbreak: Accounting implications

Introduction

The spread of corona virus (COVID-19) has caused economic shock on a global scale resulting in many countries which have drastically acted to mitigate or suppress the rapid contagion by implementing international travel restrictions (including closing of borders), community or national quarantine measures and suspending business operations. In an effort to curb the impending impact of COVID-19, the Philippine government has declared on March 8, 2020 a state of public health emergency throughout the country followed by the implementation of community quarantine measures within the National Capital Region on March 15, 2020 which was extended to cover the Luzon area in an enhanced quarantine procedures effective March 17, 2020. These quarantine measures are effective until April 14, 2020 subject to continuous monitoring and assessment of the situations. Other cities and provinces outside Luzon have been implementing substantially the same quarantine measures in a limited scope.

As COVID-19 becomes more widespread and with uncertainties it brings as to the extent of its impact to the business sector, it is important that management considers the accounting implications of the outbreak, including its impact on the preparation of the entity's financial statements.

This publication provides a summary and reminder of the financial reporting requirements that may be relevant in the preparation of entity's financial statements with reporting period ended December 31, 2019 and subsequent reporting periods, focusing on certain areas that may commonly be applicable to the affected industries and companies

Content

A. Entities affected

No entities are immune to the impact of COVID-19; however, disruption on business activities is largely felt in exposed industries such as hospitality (travel and tourism), transportation, logistics and shipment, retail and restaurant, and entertainment with chain effect also impacting the manufacturing, real estate and construction, and financial services sectors.

The initial assessment of whether the outbreak may impact a particular entity and what relevant accounting requirements may be applicable should be made based on the specific facts and circumstances of an entity, its business and the transaction it deals which may include the following, among others:

- sources of revenue stream and type of arrangement with customers (customer-based, product lines, channel of distribution or marketing)
- customers are concentrated on certain groups or sectors affected
- exclusive supply arrangement with affected vendor
- entity's vulnerability to market price changes
- distortion in the cash flows
- operational disruption caused by employees not able to work or under an alternative work arrangement
- high fixed operating costs
- reliance on external financing for working capital

Management assessment should also consider the extent of the entity's business activities undertaken with foreign countries which are also experiencing significant disruption of business caused by COVID-19 pandemic. Heavy reliance of revenue stream and supply from, and credit concentration in such affected foreign country(ies) may likely affect the entity's operations, profitability and business strategies, both in a short or long-term.

B. Accounting implications

B.1 Subsequent event review: Is COVID-19 an adjusting or non-adjusting event?

One important accounting implication for affected entities is to evaluate whether the impact of the COVID-19 is widespread, and the corollary effect of the government measures imposed to businesses and to the communities where the entities have significant operations are **'adjusting event'** or **'non-adjusting event'** in the December 31, 2019 financial statements.

Entities should consider PAS 10, *Events after the Reporting Period*, to determine whether the impact of COVID-19 is an adjusting event or a non-adjusting event. PAS 10 describes an adjusting event as one which **'provides evidence of conditions that existed at the end of the reporting period'.** In the evaluation, use of hindsight is not permitted as the financial statements shall be prepared based on information available as of the reporting date. In the Philippines, few cases of COVID-19 was initially confirmed and reported during first week of February 2020 (associated mainly from transmission by foreign visitors) while cases of local contagion with few cases of confirmed community transmission have been reported since first week of March 2020. Since then, series of government measures have been imposed to mitigate, if not suppress, the further spread of the virus including suspension of classes, community quarantine, and suspension of business operations except for those catering to healthcare and basic needs of the community.

Non-adjusting event for reporting period December 31, 2019

Based on these series of events transpiring in the country after December 31, 2019, the COVID-19 pandemic may fall into the category of a "non-adjusting" event for the financial statements as of and for the year ended December 31, 2019 of entities with domestic operations. If the impact of the non-adjusting events after the reporting period are material, PAS 10 requires entity to disclose the following:

a) the nature of the event; and,

b) an estimate of the financial effect

In cases where the estimation of the impact cannot be made due to uncertainties about the impact of COVID-19 such as, the extent and duration of community quarantine and business disruption, and the magnitude of impact on the economy and asset prices, an entity is required to disclose such fact.

For companies with foreign operations and/or investments or assets held in other countries, assessment shall be made by taking into consideration the entity's exposure in that foreign jurisdiction, and whether the spread of COVID-19 that surfaced in early 2020 provides additional evidence that the circumstance or condition related to the outbreak in such foreign country already exist as of December 31, 2019. If so, any impact of COVID-19 may be considered as an adjusting event to the December 31, 2019 financial statements.

What are the potential required disclosures?

Management acknowledges that investors and other users of financial statements want information that reflect the entity's resilience amidst the uncertainties caused by COVID-19 pandemic and that provides understanding of management's judgments and key assumptions in preparing the entity's financial statements.

Management needs to update the disclosures in its financial statements to reflect information received after the reporting period about an event in the series of events during the outbreak even when the information does not affect the amount recognized in the financial statements. **This may include for example, a disclosure of the estimated effects on losses likely to be incurred due to interruption in the supply chain, spoilages and expiration of goods in stock, potential impairment of assets, decline in value of investments, and breaches in debt covenant(s)**. In determining the estimated financial effect for disclosure purposes, management may apply, to the extent practicable, the recognition and measurement requirements of the relevant accounting standard. See section B.3 for further discussion. **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 shall be provided.

Adjusting event for reporting period subsequent to December 31, 2019

Different evaluation however shall be made for financial statements dates subsequent to December 31, 2019 where more information have been known and made available that may or shall be factored into the assumptions and assessment, hence, shall be taken into consideration in the preparation of the financial statements. These new information may likely be adjusting events affecting for example, the following:

- Fair value measurement for assets and liabilities (PFRS 13)
- Impairment of tangible and intangible assets (PAS 36)
- Expected credit loss (ECL) for financial assets (PFRS 9 and PFRS 7)
- Net realizable value of inventories (PAS 2)
- Recoverability of deferred tax assets (PAS 12)
- Useful life of property, plant and equipment (PAS 16), intangible assets (PAS 38), and right-of-use assets (PFRS 17)
- Revenue recognized based on variable consideration and constraints (PFRS 15)
- Provisions or contingent liabilities (PAS 37)
- Current or non-current classification of financial liabilities (PAS 1)

The accounting requirements and audit considerations related to these areas are discussed in section B.3 below.

B.2 Going concern assessment

Accounting requirements

When preparing financial statements, management shall make an assessment of whether events and conditions may cast significant doubt on the entity's ability to continue as a going concern (i.e., significant and probable of occurring that may lead to corporate failure), and when material uncertainty exits – assess whether the going concern assumption is appropriate. [PAS 1, *Presentation of Financial Statements*, par. 25/PSA 570, *Going Concern]*. **It is important to note that going concern assessment is required regardless of whether an event is adjusting or non-adjusting.**

When assessing whether material uncertainties exist, management shall consider and, in most cases, apply judgment about the uncertainties involved and the feasibility of realistic mitigating responses to the adverse impact to the entity caused by the uncertainty. Management should carefully consider the potential effect of COVID-19 on the entity's specific circumstances, focusing on its current and potential cash resources, including access to existing or available new financing facilities with creditors, impact of different potential scenarios (taking into consideration the different time periods of the business disruption) on its revenues, costs and expenses, and cash flow requirements, and access to any government reliefs and support measures available. High proportion of unavoidable fixed costs is likely to create more financial difficulties to the entity.

If material uncertainties exist (i.e., the magnitude of the potential impact and likelihood of occurrence is of such nature that appropriate disclosure of the information describing the implications of the uncertainty is necessary to achieve fair presentation), the following disclosures are required:

- description and significance of events or conditions;
- mitigating plans; and,
- significant judgment in concluding the appropriateness of going concern assumption

To achieve the disclosure requirements above, specific disclosures shall be made to describe how and when the uncertainty may transpire and its impact on the entity's resources, operational capacity, liquidity, solvency and viability.

If the magnitude of the potential impact may lead to deterioration of the entity's financial condition so severe that the going concern basis of accounting is no longer appropriate (i.e., liquidation basis), the financial statements should apply the general requirements of the accounting standards with respect to the measurement, recognition and disclosure. Focus shall be made on areas involving presentation and measurement of assets held for sale, impairment of assets, recognition of provisions, and classification of liabilities and equity instruments.

B.3 Other topical accounting areas

While the impact of COVID-19 to businesses will not likely affect the measurement of asset or liabilities recognized in the financial statement for reporting period ended December 31, 2019 (i.e., non-adjusting subsequent event) as discussed in section B.1, management shall consider the recognition and measurement principles under the relevant financial reporting standard(s) in estimating the financial effect of COVID-19 for disclosure purposes to comply with the requirement of PAS 10. For example, to estimate and disclose the significant decline in the recoverable amount of an asset that has become impaired subsequent to the reporting period, management shall apply to the extent practicable the requirement of PAS 36 to determine and measure the recoverable amount; hence, the disclosure of the further losses on the asset caused by COVID-19.

The same requirements shall be applied for reporting periods after December 31, 2019 to determine amount of adjustments to be recognized in the financial statements in those periods (e.g., reporting periods in 2020).

Topic areas	Requirements	Accounting considerations
Fair value measurement	The objective of fair value measurement is to reflect the exit price of an asset based on assumptions that market participants would make using available information under current market conditions at measurement date i.e., end of the reporting period. [PFRS 13, *Fair Value Measurement*, par. 9 and 24]	The fair values of quoted financial instruments (e.g., debt and equity securities and derivative) subsequent to December 31, 2019 have more likely factored in the impact of COVID-19. This provides basis to determine potential losses from the asset subsequent to the reporting period.

Topic areas	Requirements	Accounting considerations
	Potential additional disclosures • Information about the considerations of the COVID-19 in the fair value measurement in connection with PAS 10 disclosure requirement (i.e., description of the events and its current and/or potential impact to the entity). • Description of facts if unobservable inputs were changed to reflect reasonably possible alternative assumptions significantly changing the fair value, including effect of the change. [PFRS 13, par. 93] • Estimation uncertainties associated with the underlying assumptions used about the future that may have significant risk of resulting in material adjustment to the carrying amount of assets or liabilities recognized [PAS 1, par 125]	Valuation challenges, however, may arise for price or estimate of fair value based on unobservable inputs, particularly when those inputs are used in a valuation technique or model. For December 31, 2019 reporting period, fair value shall be adjusted only, if necessary, to the extent where the events or transactions associated with the outbreak provide evidence of conditions that existed at the measurement date which are known or knowable by market participants at measurement date. For example, fair value measurement of a private equity investment issued by a counterparty in China as of December 31, 2019 which did not consider the impact of the spread of the disease in the year-end remeasurement may be adjusted to incorporate the effect of the outbreak as the likelihood of the spread in China while only reported in January 2020, already existed as of financial statement date. For financial statements date subsequent to the reporting of the COVID-19 cases (e.g., as of end of February or March 2020), the remeasurement shall include information available as of those dates. Management shall revisit the entity's asset portfolio to identify foreign investments with COVID-19 exposures.
Impairment of non-financial assets	At the end of each reporting period, non-financial assets (excluding goodwill and those assets with indefinite useful life) are assessed for indications of impairment and if any such indication exist, an entity shall estimate the recoverable amount. Recoverable amount of an asset is the higher of the fair value less cost of disposal (FVLCD) and value in use (VIU)]. Asset is impaired when an entity is not able to recover its carrying value, either by using or selling it [PAS 36, *Impairment of Assets*, par. 9 and 18]. Intangible asset with an indefinite useful life is tested for impairment annually, and whenever there is an indication that the intangible asset may be impaired [PAS 36, par. 10]. *Potential additional disclosures* The standard requires more detailed disclosures about the judgment applied and assumptions used and the evidence they are based on for areas where the accounting estimate involved higher uncertainties. This may include sensitivity analysis explaining how measurement or the carrying amount may significantly change with the changes in the assumptions [PAS 1, par. 25]	With the business disruptions brought about by COVID-19 and government measures, the current or expected situation may trigger one or more impairment indicators requiring management to perform a more robust impairment assessment process. In addition, for those non-financial assets with impairment, entity needs to update assumptions used in determining the recoverable amount of assets and determine additional potential impairment losses. Depending on the asset being assessed, the determination of FVLCD may be impacted by the approach on how fair value is determined (i.e., valuation technique and model) and the reliability of the data and assumptions used in the model (see Fair Value Measurement section above). On the one hand, the determination of VIU involves estimating the future expected cash flows discounted at an appropriate rate, based on management's best estimate of economic conditions that will exist over the remaining useful life of an asset. In developing estimate, management shall make sure that the budget or forecast of future cash flows are supported by the actual subsequent performance and takes into consideration how the situations arising from the outbreak would impact the forecast model, including the length of forecast period, the growth pattern, appropriateness of the discount rate, and the reasonableness of the forecast data used.

Topic areas	Requirements	Accounting considerations
Expected credit loss (ECL) assessment for financial assets	In determining allowance for ECL, PFRS 9 requires an entity to incorporate in the model the reasonable and supportable information about past events, current conditions and the **forecast of future economic conditions** assessed based on information at the reporting date. [PFRS 9, *Financial Instruments*, par. 5]. *Potential additional disclosures* In addition to the usual disclosure requirements under PFRS 7, *Financial Instruments: Disclosures*, if the effect of changing an input, assumption and forward-looking adjustment related to the outbreak is significant in the ECL model, such information shall be disclosed. Relevant disclosure is also required if the estimation technique was changed, including the reasons thereof.	Management shall evaluate and incorporate in its accounting estimation process the severity and the potential impact of the implemented measures based on information that are available at the reporting date. Generally, economic downturn creating difficulties for customers to pay obligation, and the negative economic outlook may require increase in the provision for ECL. The evaluation may vary depending on the circumstance specific to an entity such as, credit exposure (i.e., characteristic and nature of counterparties, their location and industry), and the ECL model used. In assessing whether the impact of forward-looking macro-economic factors (e.g., forecasted GDP rate, unemployment rate or consumer spending index) assuming the spread of the disease is not contained is significant to the model, exposures within Metro Manila being the local epicentre of the outbreak with more reported cases will likely be assessed to have higher probability of expected credit losses. The ECL methodology should also consider how the chain effect of the outbreak may impact the credit assessment, not only to the counterparties or sectors directly affected by the measures undertaken but across different industries. For example, while a bank with minimal exposure on consumer loans may not be directly affected by the risk of individual creditors losing their job, unemployment may affect the consumption of retail products that may result in down turn in the retail and manufacturing industry; hence, affecting the bank's corporate exposure with those entities. The uncertainty concerning when the outbreak will be contained also matter on whether this has short-term or long-term effect to the credit quality of an exposure. Management may also need to apply judgment whether the government support programs and reliefs that can be accessed by customers may mitigate the likelihood of increase in credit risk from its exposures. Management may also need to revisit the estimate of recoveries from collateral or the effect of other credit enhancement incorporated in the ECL model as the current or future adverse situations may have already caused or may potentially cause partial decline in the value of those assets; hence, may increase the loss given default (see Asset Impairment of Non-financial Assets section above). Some customers of an entity may also have assets collateralized but have been subjected to physical and regulatory restrictions associated with government measures to regulate the use of the assets.

Topic areas	Requirements	Accounting considerations
Net realizable value of inventories	Inventories shall be measured at the lower of cost and net realizable value (NRV) at the end of the reporting period. NRV represents the estimated selling price in the ordinary course of business less the estimated costs of completion and estimated costs necessary to make the sale [PAS 2, *Inventories*, par. 6,9,28]	For industries and entities whose sales and manufacturing operations have been hampered due to community quarantine measures or related regulatory restriction, the estimation of the net realizable value (or obsolescence) may be affected by the significant decline or loss of customers creating pressure to reduce selling prices and/or less inventory turn-over, and temporary closures of manufacturing plant leading to spoilages, damage, or expiration. Valuation of inventories may be a more critical accounting consideration for retailer or wholesaler of non-essential goods.
Recoverability of deferred tax assets	The carrying amount of a deferred tax asset shall be reviewed at the end of each reporting period and shall be reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all that deferred tax asset to be utilized [PAS 12, *Income Taxes*, par. 56].	As recoverability of deferred tax assets significantly depend on the entity's profitability, the profitability forecast prepared by management shall consider adjustments to reflect the short-term or long-term implications to the entity's future profitability of the outbreak and/or the duration of the measures causing business disruptions. While the quarantine measures and mobility restrictions implemented by the government is effective until the middle of April 2020, uncertainties of possible extension of such measures shall need to be considered in the tax planning. On a short-term window for example, a recognition of deferred tax asset on net operating loss carry-over (NOLCO) or minimum corporate income tax (MCIT) expiring in year 2020 or 2021 may need to be carefully assessed amidst the slow-down of operations during the first to second quarter of the year. The expected decline in earnings during this period reduces the taxable income in the subsequent period.
Useful life of property, plant and equipment, intangible assets and right-of-use assets	The residual value and the useful life of an asset shall be reviewed at least each financial year-end and shall be changed if expectations differ from previous estimate [PAS 16, *Property, Plant and Equipment*, par. 51, PAS 38, *Intangible Assets*, par. 104]	The estimation of asset's useful life considers the economic benefit that an entity may obtain from the asset's continuing use. Indicators and impairment assessment may be triggered as a result of the impact of COVID-19 which may also result in reassessment of the asset's useful life. These may include: • reduction in the usage of the asset (based on expected capacity or physical output) • asset becoming idle due to shutting down of operation or lost of customers • significant change in asset • significant underperformance relative to projected future operating results In the process of reassessing estimated useful life, reassessing an intangible asset as finite rather than indefinite is an indicator that the asset may be impaired (see 'Impairment Assessment of Non-financial Assets' section above).
Revenue recognized based on variable consideration and constraint	In a contract where consideration includes variable amount, an entity shall estimate the amount of consideration (including an assessment of whether an estimate is constrained) to which the entity will be entitled in exchange for transferring the promised goods or	COVID-19 significantly affected consumer spending and with its corollary impact on economy, it may likely continue to change consumer behaviour during the reporting period and in the near future. It also disrupted the supply chain affecting individual consumers, the delivery and distribution of goods or services to customers, and the volume of production of goods and

Topic areas	Requirements	Accounting considerations
	services to a customer. Estimates shall be updated at the end of each reporting period. [PFRS 15, par. 50,56, 59]	supply of services by different companies. These circumstances may variably change the amount of customers' discounts, rebates, refunds, incentives and bonuses and together with other uncertainties constraining the estimate of variable consideration (including, market volatility, product obsolescence, government restrictions) may affect management estimation of variable consideration. While estimation of the variable consideration may significantly depend upon historical information, the current and future disruption of the customer pattern should be considered in determining the best estimate made by management, whether the prediction of the amount is based on expected value or most likely amount.
Liabilities, provisions and contingent liabilities	A provision and liability (i.e., present obligation arising from past events requiring settlement resulting in outflow of entity's resources) is recognized in the financial statements. Obligating event can create legal (i.e., derives from contract, legislation, or operation of law) or constructive (i.e., arising from past practice or customary) obligation for an entity. Nature and estimate of contingent liability is disclosed when outflow of settlement is more than remote. [PAS 1, par. 15, 28 and PAS 37, par. 10]	Entity's contract with employees and/or by operation of labor laws or regulations may require certain compensation or other form of benefits to be paid for employees who were laid-off for reasons beyond employee or employer controls. In addition, management needs to review the information and facts related to contingent liabilities disclosed by management that based on current situations (i.e., occurrence of events confirming the existence of possible obligation identified at financial statement date), may already require recognition of liabilities in the statement of financial position.
Current or non-current classification of financial liabilities	Liabilities are classified as current when it is due to be settled within twelve months after reporting period and an entity does not have an unconditional right to defer settlement for at least twelve months after the reporting period. Otherwise, liabilities are classified as non-current. [PAS 1, par. 69]	Management shall determine how adverse impact of COVID-19 affects the financial condition of an entity. If financial covenants (negative and positive) related to an entity's borrowings are triggered, this may result in borrowings from creditors becoming immediately demandable. If not rectified before the issuance of the financial statements, such borrowings shall be classified as current liabilities. This is regardless of the remaining contractual terms of an obligation. Management shall also consider the impact of uncured debt covenant violation on the entity's liquidity and solvency status in view of its assessment of whether the entity can continue as a going concern.

C. Implication on applicable regulatory reporting

The Securities and Exchange Commission (SEC), under the Revised Securities Regulations Code Rule 68, and the Bangko Sentral ng Pilipinas (BSP), under BSP Circulars 1074 and 1075, requires the reporting of any matter noted from the audit of the financial statements that adversely affects the entity's condition. During the external auditors' review of management going concern assessment and performance of subsequent event procedures addressing risk related to the impact of COVID-19 to the entity, the external auditor may conclude that the severity of the impact to the entity's current or future financial condition warrants reporting to the SEC and/or BSP. Such reporting matters may include or may relate to: (a) actual or potential losses the aggregate of which amounts to at least ten percent of the consolidated total assets of the entity, (b) significant doubt as to the ability of an entity to continue as a going concern, and/or (c) material internal control weaknesses which may lead to financial reporting problems (e.g., inability to assess the entity's going concern).

The following reporting process shall be observed to comply with the respective requirement:

Regulating Body	Manner of Reporting
SEC	The regulated entity shall report the findings to the SEC within five business days from the date the report on such findings was submitted by the external auditor to the entity's audit committee or board of directors. In case the regulated entity fails to submit the report, the external auditor shall, within 30 business days from submission of the findings to the entity, file a report (i.e., SEC Form Au-Rep) to the SEC.
BSP	The external auditor shall directly report the findings to the appropriate supervising department of the BSP within 15 calendar days upon discovery.