Accounting implications of the COVID-19 outbreak

As Coronavirus is becoming more widespread, it is important that businesses consider the accounting implications of the ever-changing situation.

This alert considers the impact of the Coronavirus outbreak when preparing FRS 102 financial statements for the year end 31 December 2019. However, given a large number of companies will have 31 March reporting dates which have now passed we also consider the impact the pandemic has had on preparation and audit of financial statements at this date, particularly concerning stock take attendance.

Events after the reporting period

Section 32 of FRS 102 makes a distinction between adjusting and non-adjusting events after the reporting period. In our view, the development and spread of this virus happened in 2020. It does not provide evidence of a condition that existed at 31 December 2019 and therefore is a non-adjusting event. At 31 December 2019 there were few reported cases and little confirmed evidence of its spread amongst humans. Therefore the impact of balances should be largely unaffected until quarter one of 2020.

Entities need to ensure the measurement of their assets and liabilities at 31 December 2019 is not impacted by subsequent development of the virus. For example, the impact of the decline in market value of investments between the end of the reporting period and the date when the financial statements are authorised for issue. The decline in the market value does not relate to the condition of the investment at the end of the reporting period, but reflects the circumstances that have arisen subsequently. Therefore, the amounts recognised in the financial statements for the investments are not adjusted.

If the impact of the non-adjusting event is material to the financial statements, it should be disclosed. This disclosure should include the nature of the event and an estimate of the financial effect, or it is not possible to estimate this, a statement to that effect.

When reviewing whether there is an adjusting or non-adjusting event after the reporting period, businesses will need to consider the timeline of the outbreak at their reporting date, the information that was available at that time and how it affected their operations. As the situation progressed and more information became available, these considerations will be different for reporting dates after 31 December 2019. For example, the declaration of COVID-19 as a pandemic by the World Health Organisation on 11 March 2020 and the subsequent lockdown of non-essential business and travel towards the end of March 2020 will impact 31 March 2020 reporting periods differently than 31 December 2019 reporting periods.

Stock count

Where stock is material to the financial statements, your auditors will need to gain comfort over its existence at the reporting date. As a result, they will be required to observe the physical stock count unless it is impracticable to do so. If, due to the Coronavirus, attendance at the stock count is impracticable then it may be possible to carry out alternative procedures.

For example, if you can carry out your stock count at a later date, your auditors can attend this count and roll back procedures can be performed. In order to perform roll back procedures, your auditors will need access to all stock movement since the year end, so you need to ensure your records reflect this. Alternatively, you may want to consider using technology for stock counts. If you are going ahead with your stock count, perhaps your auditor could attend by video call.

If it is not possible for your auditors to obtain evidence of stock at the reporting date, then this will have an impact on the audit report.

Revenue recognition

Revenue recognition may need to be adjusted for changes in estimates of amounts customers will pay. Given the disruption in the supply chain and reduced consumer spending, estimates of variable consideration may need to be adjusted.

Variable consideration takes many forms, including volume discounts, rebates, returns, refunds, and royalties. Consideration is also variable if it is contingent on a future event occurring or not occurring, such as meeting performance goals or deadlines, or a customer achieving a certain outcome, such as a distributor meeting a target level of gross margin upon resale. Variable consideration is estimated at contract inception and needs to be reassessed at each reporting date. Variable consideration can only be recognised to the extent it is probable a significant reversal will not occur when the uncertainty is resolved. Businesses should consider whether they have met this threshold and adjust variable consideration accordingly.

Revenue can only be recognised when collection of consideration is probable. A company may continue to sell products and services to customers impacted by disruptions caused by the Coronavirus.

Not only should businesses assess the need for write-offs or reserves on outstanding receivable balances, but revenue can only be recognised for new sales if payment is probable.

Principal risks and uncertainties

The risks and uncertainties as a result of the Coronavirus should be clearly communicated in the Directors' Report and elsewhere in the financial statements as appropriate. For example, have you considered the impact of staff shortages and production or supply delays to your business? Where mitigating actions have been taken, these steps should be reported alongside the risks.

Regulators have emphasised the need to provide up to date and meaningful disclosures when preparing year end reports – these should be 'fair, balanced and understandable'.

Going concern

Uncertainty surrounding Brexit and mounting global trade and growth concerns were already causing consternation even before the COVID-19 outbreak. Businesses are now reviewing how to manage the widespread disruption to supply chains, and how to continue trading with the lack of availability or delays to supplies. For many businesses, already under pressure, the impact of this further disruption may be more than they can bear.

It is up to each business to decide whether Coronavirus uncertainties impact their financial statement disclosures on viability and the ability to continue as a going concern.

Businesses will need to assess how the Coronavirus has impacted their company, how this affects the going concern assumption and whether the going concern assumption is appropriate. Where issues are identified in relation to the going concern assumption, additional disclosures may be required.

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