# HKFRS / IFRS UPDATE 2020/02

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## POTENTIAL EFFECTS OF THE CORONAVIRUS OUTBREAK ON 31 DECEMBER 2019 YEAR END FINANCIAL REPORTING

**STATUS**

Final

**EFFECTIVE DATE**

Immediate

**ACCOUNTING IMPACT**

Potential effects on impairment calculations, consideration of going concern, and additional disclosure requirements.

### BACKGROUND

The Coronavirus Outbreak poses a serious public health threat. In response, the PRC central government has taken a number of actions, including the isolation of certain cities in areas most significantly affected, an extension of public holidays, and restrictions on the movement of people. A number of businesses have reduced or suspended operations and have instructed employees to stay at home. The mandate quarantine policy of the Hong Kong SAR Government has stopped a large extent of business travel between Hong Kong and mainland China which may have brought further disruption to business operations.

From an international perspective, major airlines have suspended flights to mainland China and many jurisdictions have introduced entry restrictions or quarantine requirements on people who have travelled from mainland China. Many businesses have prohibited employees from travelling to mainland China.

This bring potentially significant disruption to entities having business operations in mainland China, and the disruption is very likely to affect entities which depend on supply chains which involve mainland China. It will also affect a wide range of businesses which have a high dependency on mainland China, including travel and tourism, manufacturing, construction and the retail sector. Looking more widely, there is an increase in economic uncertainty which may lead to volatility in international markets including exchange rates.

This brings potentially significant financial reporting implications, in particular considerations concerning impairment and going concern. This Update focusses on implications for periods ended 31 December 2019, but will be relevant for other reporting dates. There will also be implications for interim reports issued in 2020.

## IMPAIRMENT

For the purposes of impairment tests, an initial question is whether the financial reporting effects of the Coronavirus Outbreak are required to be accounted for in the reporting period to 31 December 2019, or as a non-adjusting post balance sheet event.

The requirement, in accordance with HKAS/IAS 10 *Events after the Reporting Period*, is to account for the significant changes in business and economic conditions as non-adjusting events because the significant development and spread of the Coronavirus did not take place until January 2020. As at 31 December 2019, only certain events and associated actions had taken place such as the Wuhan Municipal Health Committee's issue on 30 December 2019 of an urgent notice in respect of the virus. However, although cases were reported to the World Health Organisation on 31 December 2019, its announcement of Conoravirus as a global health emergency was not made until 31 January 2020 (following which national governments took action). In addition, significant measures taken by the PRC central government and by private sector organisations did not take place until early 2020.

On this basis, it is expected that forecasts, projections and associated assumptions used for the purposes of impairment testing would reflect either little or no change as a result of the Conoravirus Outbreak.

The rationale for this is that, when measuring the recoverable amount of financial and non-financial assets, it is necessary to use projections that are based on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of the asset. Those reasonable and supportable assumptions are required to be made as at the reporting date – 31 December 2019.

Consequently forecasts, projections and valuations used for impairment calculations as at 31 December 2019 will need to be reviewed carefully, in order to ensure that the significant effects of the Coronavirus Outbreak (a non-adjusting post balance sheet event) are not being incorporated through the use of hindsight.

Linked to this requirement, it will also be necessary to ensure that appropriate disclosures are made of non-adjusting post balance sheet events in financial statements for the period ended 31 December 2019. HKAS/IAS 10.21 requires that:

> 'If non-adjusting events after the reporting period are material, non-disclosure could reasonably be expected to influence decisions that the primary users of financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity. Accordingly, and 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.'

Disclosures in 31 December 2019 financial statements that may be necessary as a result of the Coronavirus Outbreak include:

- Estimates of impairment of financial (expected credit losses) and non-financial assets
- Breaches of covenants in lending or other arrangements
- Triggers of conditions which give rise to debt or other instruments being required to be redeemed (or being repayable at the option of the counterparty)
- Waivers of, or changes to, the contractual terms of lending or other arrangements
- Supply chain or other trading disruption
- Dealing with the suspension or termination of contracts, and the assessment of whether a contract for the sale or purchase of goods or services is an onerous contract.

## GOING CONCERN

HKAS/IAS 10 *Events After the Reporting Period* contains specific requirements when considering going concern. In contrast to projections used for the purposes of impairment, entities are required to consider events both before and after the reporting date, with HKAS/IAS 10.15 noting that:

> 'Deterioration in operating results and financial position after the reporting period may indicate a need to consider whether the going concern assumption is still appropriate. If the going concern assumption is no longer appropriate, the effect is so pervasive that this Standard requires a fundamental change in the basis of accounting, rather than an adjustment of the amounts recognised within the original basis of accounting.'

As a result, it is necessary to consider whether the events that have occurred after an entity's 31 December 2019 reporting date in relation to the Coronavirus Outbreak have caused a significant deterioration in economic conditions for an entity, or have introduced significant uncertainty. If so, an assessment is needed of whether this results in significant doubt on the entity's ability to continue as a going concern (HKAS/IAS 10.16(b)). In extreme cases, consideration will be needed of whether the financial statements for the period to 31 December 2019 should be prepared on a going concern basis.

If it is concluded that the going concern basis is not appropriate, then the financial statements will be prepared on another basis (often referred to as 'break-up' basis). HKAS/IAS 1.25 then requires disclosure that the financial statements have not been prepared on a going concern basis, together with the reason(s) why the entity is not regarded as a going concern.

It may be concluded that it is still appropriate for financial statements to be prepared on a going concern basis, but the implications of the Coronavirus Outbreak are such that there is or may be significant doubt about an entity's ability to continue as a going concern. In such cases, to the extent that there are material uncertainties or the conclusion that the going concern assumption is appropriate has required significant judgement, disclosures are required to be included in the financial statements.

In making its assessment of going concern, information that becomes available after the reporting date needs to be taken into account. HKAS/IAS 1.26 requires that:

> '…management takes into account all available information about the future, which is at least, but not limited to, twelve months from the end of the reporting period. The degree of consideration depends on the fact in each case…'

Consequently, management's assessment of going concern needs to incorporate all relevant information, including information about the future for an appropriate period, that has become available up to the date on which the financial statements are authorised or approved for issue. This includes updated forecast financial information, updated sensitivity analysis (which may require additional and/or different potential variances to be included), and compliance with bank and other covenants (for example, some structured debt arrangements include contractual terms which mean that the debt is repayable if actual financial results are more than a specified percentage below initial forecasts).

In circumstances in which the Coronavirus Outbreak gives rise to a material uncertainty over an entity's ability to continue as a going concern, but it has been concluded that the going concern basis of preparation remains appropriate management needs to include expanded disclosures to support its conclusion that the going concern basis of preparation is appropriate. These will include:

- Adequate disclosures about the Coronavirus Outbreak and management's plans to deal with its effects; and
- Clear disclosure that there is a material uncertainty over the entity's ability to continue as a going concern, and therefore that it may be unable to realise its assets and discharge its liabilities in the ordinary course of business.

Disclosures about the effects of the Coronavirus Outbreak are also likely to appear in the narrative sections of annual reports. These disclosures need to be consistent with those made in the financial statements, and with wider current and forecast economic and other conditions.

## BDO'S SUPPORT AND ASSISTANCE ON HKFRS/IFRS

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