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The COVID-19 impact on accounting and the solutions proposed by the international financial reporting standards for pandemic-related problems

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Abstract :

The whole world was affected by the pandemic of the new Corona virus, including in this field of economics, as accounting was not escaped from the impact of this virus, which created new accounting problems

Accordingly, we aimed through these research papers to determine the impact of COVID-19 on accounting and the solutions proposed by the international financial reporting standards to solve the problems associated with the outbreak of this pandemic, using the descriptive and deductive methods,

We extracted the most important paragraphs from the international financial reporting standards that address emerging accounting problems associated with the pandemic.

Keywords : Corona virus, International financial reporting standards, Accounting problems; pandemic, Accounting.
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1. INTRODUCTION

The effects of COVID-19 caused a significant deterioration in the economic conditions of some companies and an increase in the economic uncertainty of other companies. The organization needs to assess whether these events or conditions cause special accounting problems. It is clear that companies in the highly vulnerable sectors that suffer from low demand, low sales and margin pressure will be more affected - especially travel, tourism, hospitality / entertainment / sports, retail and the oil industry.

Over time, impacts to sectors such as cars may increase, if consumers postpone large purchases until uncertainty subsides.

Accordingly, we assume that many international bodies worked to inform the effect of and mitigate its negative aspects, so the international financial reporting standards were able to solve the related problems;

And from it begs the following question: **What is the effect of COVID-19 on accounting? And what are the solutions proposed by International Financial Reporting Standards to address pandemic-related problems?**

And from it we assume that the international financial reporting standards contained in their content specific paragraphs of each standard to address a specific accounting problem that came due to the Corona virus.

2. Methods and Materials:

It is difficult to imagine that there are many active companies that have not been affected in some way by Covid-19. All of them should be informing users of the accounts about the effects on the company's solvency, profitability and strategy.

The level and detail of disclosures surrounding the impact of Covid-19 are, of course, dependent upon the significance of the impact that Covid-19 has had.

Therefore, using the descriptive method, we identified COVID-19 impact on accounting.

We have also depended on the deductive method to extract the most important paragraphs from the International Financial Reporting Standards and the solutions proposed by them for pandemic-related problems.

3. The financial effect of COVID-19 on the entity

Direct financial impacts may include[i]:

• Asset impairment/changes in assumptions for impairment testing (AASB 136);

• Change in fair value of assets (AASB 13) or net realisable value of inventory (AASB 102);

• increased costs and/or reduced demand requiring provisions for onerous contracts (AASB 137), reassessment of variable consideration, including refund liabilities (AASB 15);

• Changes in expected credit losses for loans and other financial assets (AASB 9).

• material uncertainties that cast significant doubt on the ability to continue as a going concern such as extent of the impact on future costs and revenues (AASB 101 and AASB 110) and unknown duration of the impact.

Entities should also consider impacts arising indirectly. For example, customers, suppliers, financiers or investments in other entities may be affected, leading to impairments, increased costs or reduced revenues.

4. Inventories (IAS2):

Inventories are measured at the lower of cost and net realisable value under IAS 2 *Inventories*. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and sale[ii]. *[IAS 2.6]*

The COVID-19 outbreak may affect the estimated net realisable value in several ways.

- Estimated selling prices may fluctuate due to changes in customer demand.
- Estimated costs to complete may change due to increases in the cost of materials or labour.

Companies need to estimate net realisable value based on the most reliable evidence at the time the estimate is made. Companies consider the effect of events occurring after the end of the reporting period to the extent that they confirm conditions existing at the reporting date. These estimates may require significant judgement, particularly when inventories will not be realised for a long period of time. *[IAS 2.30]*

Companies disclose the amount of any write-down of inventories recognised as an expense in the period. *[IAS 2.36]* [iii]

Some entities may be experiencing supply chain disruptions. Real estate companies with inventories of under construction properties could be impacted by a fall in property prices. Seasonal inventories and perishable products might be exposed to the risk of loss due to damage, contamination, physical deterioration, obsolescence, changes in price levels or other causes. Companies would need to assess whether, on their reporting date, an adjustment is required to the carrying value of their inventory to bring them to their net realisable value in accordance with the principles of IAS 2 ‘Inventories’. Estimating net realisable value in such volatile market conditions may also be a challenge, on account of the uncertainties presented by the pandemic.

If an entity’s production level is abnormally low (eg due to a temporary shutdown of production), it may need to review its inventory costing to ensure that unallocated fixed overheads are recognised in profit or loss in the period in which they are incurred (ie “excess capacity” should be expensed rather than being added to the cost of inventory)[iv].

5. Leases:

Entities are experiencing operational disruptions (such as compulsory closure of bars and restaurants) due to the containment measures, leases, in particular those in the hospitality, entertainment and retail sectors, may be renegotiated or the lessor may offer rent concessions to the lessee. Depending on the nature of the concession, lessees and lessors will have to determine how to account for the concession in accordance with IFRS 16 Leases[v].

Management should consider whether the rent concession will result in a lease modification where there is a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease.

The volatile market conditions amidst the COVID-19 pandemic may trigger fluctuations in market interest rates and the entity’s credit risks (such as the borrowing rate), so when a lease is being accounted for using the lessee’s incremental borrowing rate, an entity has to reconsider and reassess an appropriate rate.

It is noteworthy to highlight that, on 17 April 2020, the International Accounting Standards Board (IASB)

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tentatively decided to provide practical relief to lessees in accounting for rent concessions arising as a result of the COVID-19 pandemic by providing lessees with an optional exemption from assessing whether a COVID-19-related rent concession is a lease modification and account for those rent concessions as if they were not lease modifications. Entities are encouraged to monitor the progress and final decisions[vi].

Table 1. reporting on leases

When…	Lessor	Lessee
A rent concession granted by the landlord is given in form of short-term reduction in lease payment that result in a lease modification (i.e. with a change in the consideration of the lease)	To consider the reallocation of consideration in the contract, reassessment of lease term, liability and lease classification • To apply IFRS 16, para. 79-80 if it is a finance lease and apply para. 87 if it is an operating lease	To consider the reallocation of consideration in the contract, reassessment of lease term, liability and lease classification • To apply IFRS 16, para. 44-46
A rent concession granted by the landlord is due to contractual obligations or applicable laws governing the contact (i.e. without any lease modification)	• In an operating lease – to recognise the effect of the rent concession by recognising lower income from the lease • In a finance lease - continue to account for the	• To account for as a variable lease payment and recognise in profit or loss when the associated variability is resolved

	lease under its original terms and conditions, but the carrying amount of the net investment in the lease will be subject to adjustment/ impairment	
When a lessee receives compensation from a local government directly	• Not applicable	• To consider whether the compensation received is a government grant in accordance with IAS 20 Government Grants and as discussed in the previous Section

Source: MOORE, (2020), COVID-19 FINANICAL REPORTING IMPLICATIONS FOR ACCOUNTING PERIODS ENDING AFTER 31 DECEMBER 2019, MOORE Global, p6.

6. The determination of financial assets fair value under covid-19 outbreak:

Some of the key factors and risks to consider when measuring fair value using a valuation technique include the following[vii]:

- Economic activity levels. Measures taken to contain the virus may lead to a significant reduction in economic activity in terms of production of and demand for goods and services, and may have a negative impact on forecast future cash flows used in a discounted cash flow valuation method.

- Credit risk and liquidity risk: The uncertain economic environment has resulted in increases in credit risk and liquidity risk for many companies. Own credit risk and/or counterparty credit risk used as inputs into valuation techniques may therefore increase.
- Forecasting risk: Fair value measurements should reflect the greater uncertainty in making economic and financial forecasts in the near term, due to the difficulty in forecasting the magnitude and duration of the economic impact of COVID-19.
- Foreign exchange risk: Companies with significant sales or purchases in foreign currencies may be adversely affected by exchange rate movements.
- Commodity price risk: Companies in extractive industries may be significantly affected by decreases in commodity prices. Companies in countries that are economically dependent on these commodities may also have greater risk of adverse economic impacts.

7. Financial Instruments and Contract Assets- *Impairment and Valuation Considerations*:

As a result of the pandemic, entities may need to assess their investments and loans for impairment. Investments that may be affected include equity securities and private debt and, in certain instances, investments in sovereign debt. Moreover, the COVID-19 pandemic may cause additional volatility in the global markets, which has affected the fair values of investments (e.g., credit spreads may widen or the creditworthiness of counterparties may be affected).

The following guidance applies to investments in equity securities that are not accounted for at fair value with changes in fair value recognized in earnings[viii]:

Equity securities without readily determinable fair values

ASC 321-10-35-3 and 35-4 address the subsequent measurement of equity securities without readily determinable fair values that are accounted for by using the measurement alternative described in ASC 321-10-35-2. ASC 321-10-35-3 states, in part, that “[a]n equity security . . . measured in accordance with paragraph 321-10-35-2 shall be written down to its fair value if a qualitative assessment indicates that the investment is impaired and the fair value of the investment is less than its carrying value.”

ASC 321-10-35-4 further states that for such an impaired equity security, “an entity shall include an impairment loss in net income equal to the difference between the fair value of the investment and its carrying amount.” Because the fair value of such an investment is not readily determinable, the entity will need to estimate the fair value under ASC 820 to measure the amount of the impairment loss. Once an investment in an equity security that is measured under ASC 321-10-35-2 is impaired, the entity cannot recognize a recovery in the investment’s fair value in the absence of an observable price change for an identical or a similar security, as discussed in ASC 321-10-35-2.

ASC 321-10-35-3 requires entities to perform a qualitative assessment in each financial reporting period to evaluate whether equity securities accounted for under the measurement alternative in ASC 321-10-35-2 are impaired. That qualitative assessment is performed on the basis of the impairment indicators in ASC 321-10-35-3.

Entities should note that ASC 321-10-35-3(c) applies particularly to the COVID-19 impacts; it states, in part, that one indicator of impairment is “[a] significant adverse change in the general market condition of either the geographical area or the industry in which the investee operates." This impairment indicator will often be met as a result of significant declines in equity prices globally that have occurred as a result of the COVID-19 pandemic.

In the evaluation of an equity security for impairment, neither the significance of the impairment amount nor the impairment's duration is relevant. Although the fair value of nonmarketable equity securities may be difficult to measure because of the unobservability of inputs, entities that have investments whose fair values have been affected by the pandemic must make a reasonable estimate of fair value when recognizing impairment losses.

Such impairment losses must be recognized for declines in fair value below the carrying amount even if the investor believes that such declines are temporary in nature.

In addition to evaluating and recognizing an impairment, an entity would write down the carrying amount of an equity security that is accounted for by using the measurement alternative in ASC 321-10-35-2 if an observable price change in an identical or a similar security reflects a fair value that is below the investment's previously recorded carrying amount.

8. Disclosing impairment in interim financial statements:

In the current market conditions, companies should ensure that the minimum disclosure requirements of IAS 34 are supplemented by additional disclosures, if they are relevant to an understanding of their interim results, position and cash flows, including:

- changes in significant judgements and assumptions made by management, as well as areas of estimation uncertainty as required by IAS 1[ix]; and

- Overarching disclosures of the impact of the COVID-19 outbreak on the interim financial position, performance and cash flows. *[IAS 34.15, 15B(d), 15C, IAS 1.17(b)–(c), 122, 125]*

IAS 34 contains other specific disclosure requirements for financial assets and/or financial liabilities[x]. *[IAS 34.15B(h), (k), (l), 16A(j)]*

Some regulators have emphasised that, given the magnitude of the latest economic changes, companies should provide in their interim financial statements sufficient disclosure for investors to understand the significant events and transactions that have occurred since the annual financial reporting date. *[IAS 34.15B, 16A]*

Companies need to consider whether their 2020 interim financial statements provide sufficient information because investors and other users may expect information above and beyond what is typically disclosed. Condensing or omitting disclosures on the assumption that users have access to the most recent annual financial statements may no longer be appropriate – i.e. information disclosed in the 2019 annual financial statements may be less relevant in the current circumstances.

Actions for management to take now[xi]:

- Assess the company's ability to continue as a going concern at the interim reporting date.
- Consider whether information disclosed in the last annual financial statements remains relevant. If not, then provide updated disclosures.
- Assess and reflect the impacts of the COVID-19 outbreak in the interim financial statements – in particular, whether uncertainties are factored into all the necessary estimates and judgements.
- Assess whether the disclosures and explanations provided in the interim financial statements are sufficient for users to

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understand the significant events and transactions that have occurred since the annual reporting date.

- Provide additional disclosures to enable users of interim financial statements to understand the overall impact of the COVID-19 outbreak on the financial position and performance of the company.

9. Example disclosures for non-adjusting events:

All disclosures should be entity-specific and include information relevant to their circumstances. The following are some examples for some potential non-adjusting events for 31 December 2019 financial statements[xii]:

9-1. Overall risk to operations

Since 31 December 2019, the spread of COVID-19 has severely impacted many local economies around the globe. In many countries, businesses are being forced to cease or limit operations for long or indefinite periods of time. Measures taken to contain the spread of the virus, including travel bans, quarantines, social distancing, and closures of non-essential services have triggered significant disruptions to businesses worldwide, resulting in an economic slowdown.

Global stock markets have also experienced great volatility and a significant weakening.

Governments and central banks have responded with monetary and fiscal interventions to stabilise economic conditions. [Add description specific to how the entity's financial position and performance has or is likely to be affected]

The Company has determined that these events are non-adjusting subsequent events. Accordingly, the financial position and results of operations as of and for the year ended 31 December 2019 have not been adjusted to reflect

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their impact. The duration and impact of the COVID-19 pandemic, as well as the effectiveness of government and central bank responses, remains unclear at this time. It is not possible to reliably estimate the duration and severity of these consequences, as well as their impact on the financial position and results of the Company for future periods. Note: this disclosure assumes there is no significant doubt about the entity's ability to continue as a going concern.

9-2. Store closures

On 1 March 2020, in response to significant decreases in demand resulting from social distancing efforts, quarantines and border closures related to the spread of COVID-19, the Company announced that it would temporarily close 30 of its 100 stores, which represented average monthly sales of approximately CU325,000 during the year ended 31 December 2019.

The closures are expected to reduce the following expenses by the following amounts on a monthly basis.

The Company also announced that it would continue to pay its store associates for all scheduled shifts that were planned for the two-week period beginning on 1 March 2020. The salaries and benefits expense estimated for this two-week commitment is approximately CU50,000.

9-3. ***Redundancies***

During March 2020, in response to significant decreases in demand amidst the COVID-19 outbreak, the Group announced its intention to temporarily reduce its workforce by 100 positions by the end of April 2020, by means of either reduction in hours or temporary leave. The Group plans to continue providing health benefits for furloughed employees through to 30 June 2020. The Group expects the reduction in positions to reduce salaries and benefits expense in 2020 by a net amount between CU25,000 and CU20,000 per month. Other expected financial effects include.

9-4. Customer defaults

Subsequent to 31 December 2019, one of the Company's major trade customers declared bankruptcy following severe decreases in sales as a result of the continued spread of COVID-19. Of the CU135,000 receivable from this customer, the Company expects to recover less than CU10,000. The allowance for expected credit losses for this receivable was CU5,000 as at 31 December 2019.

9-5. Decline in fair value of investments

Since 31 December 2019, the outbreak of COVID-19 and related global responses have caused material disruptions to businesses around the world, leading to an economic slowdown. Global equity markets have experienced significant volatility and weakness. As at 31 March 2020, the date that these financial statements were authorised for issue, the fair value of the Group's investments had declined significantly to the following amounts.

While governments and central banks have reacted with monetary interventions designed to stabilise economic conditions, the duration and extent of the impact of the COVID-19 outbreak, as well as the effectiveness of government and central bank responses, remains unclear at this time.

These subsequent changes in the fair value of the Organization's investments are not reflected in the financial statements as at 31 December 2019.

10. Conclusion:

The world was affected by the COVID-19 coronavirus, which created global motherhood with a significant economic impact on entities due to restrictions on production, trade, and consumption. Or because of travel and other bans. These conditions have an impact on the accounting and reporting process.

However, further development, duration and impact of coronavirus are not predictable.

But through our research, we found that the accounting bodies have already prepared international financial reporting standards that are able to provide solutions to the emerging accounting problems that were caused by the Corona virus.

11. Results and discussion :

Through our study, we came to determine the impact of the pandemic outbreak on accounting as well as the most important emerging accounting problems and from it we extracted solutions provided by the International Financial Reporting Standards to address the problems associated with COVID-19.

1.With regard to the problem of the financial effect of COVID-19 on the entity, it was addressed by AASB 13/10/15/9.

- With regard to Inventories, Ias2 was considered to propose solutions for pandemic related problems.
- With regard Leases, IFRS 16was sufficient to address the problems associated with COVID-19.
- As for the fair value IFRS 13 and IAS 1 contain special disclosure requirements due to COVID-19.
- With regard to Financial Instruments and Contract Assets are subject to the impairment and disposal guidance in ASC 321

- With regard to disclosing impairment in interim financial statements, IFRS 34 do the job.
- At the end we propose an example disclosures for non-adjusting events.
- Financial reporting has also been affected after the reporting date due to COVID-19, and that has been dealt with in IAS 10.

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