ACCA Think Ahead

Observed effects of covid-19 outbreak on corporate reporting – preliminary survey

Objective of the survey

The survey intends to gather information to help members understand how the pandemic is impacting on corporate reporting and to gather some practical examples for them. It supplements other available analyses such as the thematic review on corporate reporting published recently by the Financial Reporting Council in the UK.

Method

Through the survey, we aimed to carry out a limited review of a sample of corporate reports to gain an impression of how the effects of virus, and of the measures taken to limit its spread are being reported by companies. Our review did not consist of a complete read of the entirety of companies' reports and accounts but focused primarily on the financial statements and more specifically

- Income statement
- Supporting notes
- Relevant accounting policies
- Notes on property, plant and equipment (PP&E), intangibles, inventories and financial assets
- Notes on provisions
- Notes on estimations/judgements
- Notes on events after the end of the reporting period

The review did also look at covid-19 discussion in the reports outside of the financial statements in the

- Auditors' report
- Audit Committee report if any
- Financial review from the directors

The reviews were looking for reference to the impact of the pandemic measures for example in the following

- Impairment of financial assets at cost
- Impairments of other assets – inventory, intangibles, PP&E, right of use leased assets
- Going concern statements and disclosure of material uncertainties
- Lease holidays
- Provisions for restructurings or onerous contracts
- Presentation in the income statement – as unusual/exceptional items for instance
- Key audit matters and any emphasis of matter in audit reports
- Financial review on effects and forward-looking information in the management/narrative report

The sample

Details of our sample are set out in the Appendix. At 35 it was is a limited sample, consisting primarily of companies in those sectors that we expected to be most adversely impacted. The sample covered only listed companies reporting following IFRS from six countries and where the report is in English. In this preliminary report the companies were mostly those with reporting periods which ended before the main impacts of the pandemic were felt, for example December 2019 and January 2020 year ends, but had been approved after the impact was clear in March or later. The sample, however, also included some with periods ending in March 2020 when the effects may have started to be more clearly felt.

The December and January period ends all were pre-covid. The February ones were split between some that treated the impact as after the period and some within the period. There was one company with a period ending 7 March that treated the covid effects as being after the period. The periods covered were therefore either before the crisis or at a fairly early stage of it. Most of the accounts were being approved during May and June and so further on through the crisis, but still not at a point where the resolution was clear in most cases.

Reporting period ends	**Pre covid-19**	**Post covid-19**
December 2019	14	
January 2020	2	
February 2020	3	2
March 2020	1	12
April 2020		1
Totals	**20**	**15**

The companies selected were weighted towards those in sectors where we expected the impact of the pandemic to be relatively strong, such as such as non-food retail, travel, leisure, construction and oil. Our sample also included some where the effect might have been expected to be more neutral for now such as food, utilities, and telecoms.

In summary the sample can be characterised as follows

	Hard impact expected	Neutral impact expected
Travel	5	
Leisure	7	
Non-food retail	6	
Oil and gas	2	
Construction	5	
Property	1	
Motors	1	
Media		1
Mining		1
Utilities		2
Telecoms		2
Food		2
Totals	**27**	**8**

Going concern

Financial statements should generally be prepared on a going concern basis, unless this would not be appropriate because the company is intended to be wound up or there is no realistic alternative to do so. All of the companies in our sample prepared their accounts on that basis. Even where the going concern basis is used, if companies consider there are material uncertainties about going concern then these should be disclosed. Auditors have particular responsibilities as regards the going concern assumption: if there are material uncertainties they should include an emphasis of matter drawing attention to the issue without modifying their opinion overall.

The measures taken to counter the pandemic, such as lockdowns, closure of travel, shops, offices and construction sites, have made many sectors vulnerable because there will be periods when little or no revenue will be received and significant extra costs may be incurred, along with a looming recession and uncertainty over how long the impact of the measures may last. One might expect that this will be a key consideration in many of these accounts and especially for those sectors that will be affected in an immediate way.

In this sample of 35 companies, we found there were 10 cases of material uncertainty disclosure and emphasis of matter. All of these were among the hard impact companies. Most of the uncertainties concerned refinancing by, or to general continuing financial support from shareholders or lenders. In other cases the issues were the risk of breaches of covenants related to borrowings, or to the length of closure of stores for example. It was not always clear that covid-

19 was the prime factor behind the uncertainties – some of the entities had been loss-making already and the oil industry's problems may have arisen from the falling price of oil or carbon reduction measures which predated the pandemic. Disclosures of material uncertainties are always likely to be very sensitive matters and may induce commercial reactions from trading partners, credit ratings agencies, lenders and other parties. In general the wording was consistently presented in the management report, the notes to the financial statements and the auditor's report.

Example: Cineworld (December 2019)– assessment and material uncertainty disclosed

In the downside scenario analysis performed, the Board has considered the potential impact of the COVID-19 outbreak on the Group's results. In preparing this analysis the following key assumptions were used: the impact of a total loss of revenue across the enlarged estate for between one and three months, no fixed costs reductions should sites be closed, run rate combination benefits of c.$133m expected to be achieved as part of the Cineplex acquisition, forecast capital expenditure reduced in 2020 by 90%, and cessation of dividend payments from 1 July 2020. This analysis does not take account of the fact that in the case of widespread site closures the films scheduled to be released during this period of closure could be moved to later in 2020. These downside scenarios are currently considered unlikely, however it is difficult to predict the overall outcome and impact of COVID-19 at this stage. Under the specific downside scenario, however, of the Group losing the equivalent of between two and three months' total revenue across the entire estate there is a risk of breaching the Group's financial covenants, unless a waiver agreement is reached with the required majority of lenders within the next twelve months. Only the specific downside scenario detailed above would indicate the existence of a material uncertainty which may cast significant doubt about the Group's ability to continue as a going concern. The Consolidated Financial Statements do not include the adjustments that would result if the Group was unable to continue as a going concern.

This wording is used in the report of the Audit Committee, the auditors' report and the accounting policy note.

In many cases the companies provided thorough explanations of their assessment including different scenarios – often base case and then severe downside but plausible scenarios. This was not always the case, though, and some merely stated that the assessment had been made and described the outcome.

Example: Henry Boot (December 2019) – assessment but no material uncertainties.

Following the recent outbreak of the COVID-19 pandemic the Directors have further considered its potential impact on the Group. They have stress tested the effect of both a three-month and six month UK lock down during which time minimal activity occurs. None of the modelling undertaken by the Directors gives rise to any breach of bank facility covenants. However, as one of the covenants references the loan to value ratio of the investment property portfolio the full facility would not be available to the Group unless re-investment in the portfolio was undertaken. The facilities also contain a covenant relating to the ratio of EBIT (Earnings Before Interest and Tax) on a 12-month rolling basis to senior facility finance costs. Our most severe downside modelling, *which reflects a near 55% reduction in revenue levels from our pre COVID-19 budget for 2020, demonstrates headroom over this covenant throughout the forecast period to the end of June 2021*

In 19 cases, the assessment of the going concern basis was highlighted as a key audit matter (KAM) by the auditors. These were by no means restricted to companies in the hard impact sectors – 6 out of 8 of those in the neutral sectors had a going concern-related KAM. Work carried out to address the KAM tended to provide assurance that the going concern basis had been rightly applied and disclosed and supported any areas where the auditors might supplement the information provided by the company.

Given all the uncertainties referred to above it is rather surprising that there were 9 cases where there was neither a material uncertainty disclosed by the company nor a KAM on going concern, 7 of which were from companies in the hard impact sectors.

Events after the end of the reporting period

The requirements in IFRS include the consideration of any events that occur after the end of the reporting period but before the financial statements were approved. They distinguish those that provide evidence of conditions that existed at the end of the period (adjusting events) and those that pertain to conditions that arose after the reporting period (non-adjusting events). As the name suggests non-adjusting events do not affect the value of assets and liabilities, but if material need to be disclosed together with an estimate of the financial effect.

As noted above the “covid-19 impacts date” may have varied from business to business. While for the December period ends the covid-19 impacts were clearly non-adjusting and the March ones clearly adjusting, there was some divergence for the February ones with two treating it as an adjusting event and four as a non-adjusting. The reasoning for the two in the post covid-19 camp was that though the measures were not in place in their countries of operation the pandemic had started and measures were inevitably going to happen.

Example: Trainline (29 February 2020)

On 30 January 2020, the spread of the novel Coronavirus (COVID-19) was declared a public health emergency by the World Health Organisation. Though the impact of COVID-19 did not materially impact the Group in the year ended 29 February 2020, it has not been considered a non-adjusting post balance sheet event, in line with IAS10 on the basis that it occurred during the financial year.

Given the widespread and large impacts of the covid-19 measures, our expectation would be that all of the pre-covid sample of 20 would have such disclosure included in the financial statements. In 5 instances this was, however, not the case.

There were relatively few cases where the financial effect of the non-adjusting event was fully disclosed. The difficulties in forecasting noted above in terms of going concern were cited sometimes here. Some companies reported the items in their financial statements that were likely to be most affected even if they did not quantify them. Some disclosed that impairments of assets had been estimated but were unlikely to be material.

Example: Kenya Airways (December 2019) Post reporting date events note

The Group has performed a line-by-line analysis of the statement of financial position to assess whether the current uncertainty may impact any of the amounts presented as at 31 December 2019 as highlighted below. Due to uncertainty arising from the fluid nature of the situation, it is not practicable for the directors to reliably measure the impact on the balances at future reporting dates.

Borrowings

The Group is currently having discussions with its lenders to defer loan principal and interest payments due in 2020. This has no material effect on the consolidated and company financial statements as at 31 December 2019.

Leases

The Group is currently having discussions with its lessors to defer lease payments due in 2020 and modify the leases that were in place as at 31 December 2019. This has no effect on the consolidated and company financial statements as at 31 December 2019.

Hedge Accounting

The Group has designated sales as a hedged forecasted transaction in a cash flow hedge accounted for under IFRS 9. As at 31 December 2019 the transaction was accounted as a 'highly probable forecasted transaction' and any effective portions of changes in fair value were recognised in other comprehensive income. Due to the impact of the reduced capacity the sales amounts may be lower than forecasted and the Group will need to determine whether sales are highly probable and therefore whether it can still apply hedge accounting. This has no effect on the consolidated and company financial statements as at 31 December 2019.

Impairment of aircraft and related equipment

The Group's recoverable amounts of the aircraft and related equipment were based on fair value determined by independent valuation based on market conditions as at 31 December 2019 and not value in use that uses future estimates of cash flows. Any future decrease in fair value of the aircraft and related equipment arising from changes in market conditions is likely to result in further impairment of these assets. However, this has no effect on the consolidated and company financial statements as at 31 December 2019.

Expected credit loss (ECL)

The impact of this outbreak on the historical loss rates and macroeconomic forecasts will be incorporated into the Group's IFRS 9 estimates of expected credit loss provisions in 2020. This has no effect on the consolidated and company financial statements as at 31 December 2019.

Post covid – impairments of assets

For those where the covid measures were reflected in the financial statements, out of 15 only 2 did not report any covid-19 related impairments of assets. One of these was a February year end and the other was in a neutral sector (food).

The most common (but often not the largest) were impairments of financial assets and, given the nature of the companies, most were against trade receivables or amounts owed by joint ventures.

There was evidence in most cases that the impairments had taken into account the changed situation and not relied simply on previous experience. An airline had a major loss from ineffective hedging arrangements after the consumption of fuel dropped away as the fleet was grounded.

Goodwill impairments were recorded in a couple of cases, reflecting reduced cash flows and increased discount rates as a pandemic effect, but whether covid-19 was solely behind these was not clear.

Example

Vodafone (March 2020) on goodwill impairments

Management considered the following reasonably possible changes in the key adjusted EBITDA and long-term growth rate assumptions, leaving all other assumptions unchanged. Due to increased uncertainty following the COVID-19 outbreak, management has widened the range of reasonably possible changes in the key adjusted EBITDA growth rate assumption to plus or minus 5 percentage points (2019: 2 percentage points).

Impairments of other assets included PP&E, joint ventures and right-of-use leased assets were being triggered at a number of the companies in the hard hit sectors. Given the nature of the events and the prospects it is hard to see why in one case (an airline) the company specifically stated that no impairment of its fleet had been triggered.

Inventories were significantly impaired at clothing retailers because of obsolescence, whilst perishable items in the hospitality sector and developments in progress at a construction company were impaired because of likely delayed completion and lower sales prices expected.

As noted with going concern, the impacts of covid 19 might not be separable from other factors. So the investment properties at fair value had declined because of falling rents of retail units before the lockdown.

A number of companies reported the increased uncertainties involved in some of the impairment calculations. The unprecedented nature of the crisis making forecasting cash flows even more difficult than before was quoted, but also the lack of transactions making market/realisable values harder to determine. The external property valuers at Land Securities referred to this as a material uncertainty in their report.

Example: Burberry (March 2020)

COVID-19 has impacted both business operations and financial markets worldwide. The ultimate impact of this pandemic is unclear and hence the measurement of its impacts requires a significant degree of estimation. The financial statements for the 52 weeks to 28 March 2020 include costs relating to the impairment of the carrying value of assets as a result of the expected impact of COVID19 on the Group's activities and future trading as adjusting items.

Impairment of retail cash generating units - COVID-19 is expected to have a significant impact on the Group's retail operations in the next 12 months and beyond, with many of its retail outlets currently closed as a result of government restrictions in a number of countries worldwide. As a result management have carried out a review for potential impairment across the whole retail portfolio. The impairment review compared the value-in use of the retail cash generating units, based on managements' assumptions regarding the likely future trading performance (taking into *account the effect of COVID-19) to the carrying values at 28 March 2020. Following this review, a charge of £156.5 million was recorded within net operating expenses for impairment of retail store assets due to the impact of COVID-19. A charge of £28.4 million was recorded against property, plant and equipment and a charge of £128.1 million was recorded against right-of-use assets. A related tax credit of £28.7 million has also been recognised in the year. This charge has been recognised as an adjusting item arising as a result of COVID-19, in accordance with the Group's accounting policy, as it is considered to be material and one-off in nature. Refer to note 13 for details of impairment of retail cash generating units.*

Impairment of inventory - Management assesses the recoverability of the carrying value of inventories at every reporting period and, where the expected recoverable amount is lower than the carrying value, a provision is recorded. Typically, inventory provisions are recorded against aged inventory or specific products which have been identified as having a low expectation of future sale. Due to the impact of COVID-19, the closure of many of the Group's retail stores worldwide and the associated build-up of inventory, management have reassessed their plans for the usage of inventory over the next 12 months, taking into account the expected length of the shutdown, products ordered for future seasons and the Group's projected future sales. As a result of this reassessment, management have identified additional inventory which is no longer expected to realise its carrying value. Provisions of £68.3 million have been recorded against this additional inventory, which relates to current and recent seasons that under more normal circumstances would be expected to sell through with limited loss. This additional charge for inventory provisions has been presented as an adjusting item arising as a result of COVID-19, in accordance with the Group's accounting policy, as it is considered material and one-off in nature. A related tax credit of £12.5 million has also been recognised in the year. Refer to note 17 for details of inventory provisions.

Post-covid – liabilities

Compared to asset impairments, there were many fewer instances of liabilities arising from covid-19 or increased by it. Those that we did identify included some onerous contracts and an indication that defined benefit pension obligations might be increasing. Given that all of the reports were for periods (March 2020 most often) where the covid impact was still largely in the future, provisions arising from reorganisations stemming from the virus did not appear in many reports.

Covid impact on performance

Only in 3 of the 15 cases was there a separate amount disclosed in the income statement for covid effects. In one case there was an exceptional item of cost for the impact. In the two other instances a columnar presentation was adopted and covid 19 impairments appeared (among others) in the middle adjustments column between an underlying performance and a reported (GAAP) number. In neither case was there an attempt to adjust the revenue reported, for store closures for example.

Example: Crest Nicholson

Crest Nicholson Holdings plc
Half Year Results for the six months ended 30 April 2020

Condensed Consolidated Income Statement

	Note	Half year ended 30 April 2020 (unaudited) Pre-exceptional items £m	Half year ended 30 April 2020 (unaudited) Exceptional items (note 5) £m	Half year ended 30 April 2020 (unaudited) Total £m
Revenue	4	240.0	-	240.0
Cost of sales		(204.1)	(43.2)	(247.3)
Gross profit/(loss)		**35.9**	**(43.2)**	**(7.3)**
Administrative expenses		(24.8)	(4.5)	(29.3)
Net impairment losses on financial assets		-	(7.4)	(7.4)
Operating profit/(loss)		**11.1**	**(55.1)**	**(44.0)**
Finance income		1.7	-	1.7
Finance expense		(7.2)	(0.6)	(7.8)
Net finance expense		(5.5)	(0.6)	(6.1)
Share of post-tax results of joint ventures using the equity method		(1.1)	-	(1.1)
Profit/(loss) before income tax		**4.5**	**(55.7)**	**(51.2)**

COVID-19 related impairments

Inventory impairment

The COVID-19 pandemic has caused significant disruption to the housing sector and created future economic uncertainty. Analysts and commentators are forecasting price reductions in the residential and commercial markets. In light of this the Group have performed a detailed impairment review of inventories, resulting in an exceptional charge in the period of £43.2m.

- *NRV on current operational developments £33.9m Management derived sales price reductions of 7.5% and 32.0% for residential and commercial units respectively using a wide range of market forecasts and management experience. These were then applied against the financial appraisal of all current developments, along with other site specific provisions where considered necessary, and those producing a resulting negative margin were provided for. Three developments comprise the majority of the write down.*
- *Abortive WIP £9.3m This relates to a complex mixed-use scheme in Kent, on the River Thames. Following the application of the sales price reductions as noted above the scheme is no longer expected to be profitable. Therefore the Group have decided not to complete the scheme resulting in work-in-progress to date being written off, and costs arising from contractual obligations have been provided for.*

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A number of companies reported on the extent to which they or had not made use of government assistance – guaranteed loans, subsidies, tax reliefs and job retention schemes for example. Few reported much impact in the financial statements. In one case, there was an accounting policy for showing the job retention payments received as a reduction of the employee costs.

Likewise, though a number of companies referred to negotiations under way with landlords for rent holidays, in only one instance had the IASB's emergency practical expedient added to IFRS16 for accounting for these been used.

Example: Chow Tai Fook Jewellery Group (March 2020)

6. Other Gains and Losses 6. 其他收益及虧損

		2020 HK$ million 百萬港元	2019 HK$ million 百萬港元
Net foreign exchange loss	匯兌虧損淨額	(234.0)	(241.2)
Loss on disposal of property, plant and equipment	出售物業、廠房及設備的虧損	(37.7)	(17.8)
Gain on surrender of right-of-use assets	處置使用權資產的收益	78.8	–
Rent concession	租金優惠	34.3	–
Gain on acquisition of subsidiaries (note 38)	收購附屬公司收益(附註38)	18.0	–
Others	其他	(6.5)	(17.2)
		(147.1)	(276.2)

Rent concession represents the change in lease payment arising from COVID-19-related rent concession of HK$16.2 million and other concession that were contractually obliged by lessors of HK$18.1 million.

租金優惠指2019冠狀病毒相關的租金優惠產生租賃付款變動16.2百萬港元以及出租人須承擔的合約責任之其他優惠18.1百萬港元。

The one landlord (Land Securities) in the sample was providing against the immediate rents, but did not seem to have come as yet to many lease holiday arrangements.

Covid-19 reporting outside of the financial statements

The presentation of the reporting of the impacts outside of the financial statements (in the management, directors or strategic report depending on the jurisdiction) was not the main focus of this survey. We did, though, look at reports for forward financial assessments included there instead of, or in addition to some of the disclosures in the financial statements on the going concern assumptions and the note disclosure of events after the end of the reporting period.

In the great majority of cases there was discussion of the impacts looking forward in the management report and how the company was responding to the changed environment.

Example: Ryanair (March 2020)

Most of Ryanair's fleet was grounded from mid-March by EU Government flight bans and restrictions. These groundings reduced our March and full year traffic by over 5m guests and cut FY20 profits by over €40m. As updated on 1 May, Ryanair expects to operate less than 1% of its scheduled flying programme in Q1 (Apr. to June). Some return to flight services is expected in Q2 (July-Sept.) and Ryanair expects to carry no more than 50% of its original Q2 traffic target of 44.6m, as bookings will be impacted by public health restrictions (temperature checks and face coverings for passengers and staff) and quarantine requirements.

Since mid-March, the Group has implemented a series of measures to preserve cash, cut costs, cancel share buybacks and defer operating and non-essential capex spending. As a result, average weekly cash burn has dropped from approx. €200m in March to just over €60m in May.

However there was a significant minority (10) where there was little or no discussion in the report. The management report was sometimes a purely historical document supplementing and explaining the record in the financial statements. There is clearly a jurisdictional element to this and either market practice or regulations influence this. But in these unprecedented circumstances, a purely historical report on 2019 for example written in April or May 2020 with no mention of the pandemic reads very oddly, when the effect going forward of the emergency measures would be in every reader's mind.

In some of these instances there was good disclosure given in the events after the reporting period note of the likely financial effect. That would help but the management report would allow the company to explain not only that effect, but their strategic response, the other measures taken and the risks and opportunities the crisis presents.

Conclusions and takeaways

Going concern

- In the hard hit sectors there was a relatively high incidence (about one in three) of acknowledged material uncertainties about the entities being going concerns
- Downside but plausible cash flow scenarios indicating a possible problem are amounting to material uncertainties
- The focus must be not just on the available cash and arranged borrowings, but also on the covenants on different loans
- Given the sensitivities around these disclosures, consistent wording would be desirable in the management report, auditors report and notes to the financial statements
- Even where no material uncertainties are disclosed, good information about the assessment is reassuring and the auditors may well want to identify this as a key audit matter

Events after the reporting period

- Ensure these are fully disclosed in the financial statements. For periods before the impact it was surprising to see cases where covid-19 was not disclosed as a non-adjusting event
- While for December and January year ends covid-19 was clearly a non-adjusting event and for March year ends clearly adjusting, February ones involved more judgement. Similar judgements may be required in the future depending upon the trajectory of the pandemic and government responses.
- Though the picture is mixed, many companies were providing indications of the financial impact of any non-adjusting events.

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Impact on numbers in the financial statements

- For companies other than financial ones, the most common asset impairment is likely to be of the trade receivables and this should be done taking the post-pandemic situation into account as best as can be done.
- The immediate direct impacts and the medium-term economic prospects should in many cases trigger impairment reviews for PP&E and intangibles
- Asset values may well seem more difficult to estimate than normal given the uncertainties around the future shape of measures and of economic downturns, but estimates must be done and the uncertainties should be managed with disclosures
- Liabilities generated by covid-19 are likely to be increasing features as reporting starts of periods well into the crisis and are likely to include onerous contracts, restructurings and pension obligations.
- Separate presentation in the statement of profit or loss of material costs incurred as a result of the pandemic may well be relevant.

Reporting outside the financial statements

- In difficult and unprecedented times, information supplementing the financial statements will be more important than ever, especially of the business' strategic responses and giving indications of performance and prospects. Maximum transparency to shareholders and markets is called for.
- Consider where the report has been primarily historical, including up-to-date and forward-looking information.

Other sources on observed reporting

The Financial Reporting Council in the UK has published a Thematic Review on the reporting of Covid-19 (noted above) as well as two earlier reports by FRC's Financial Reporting Lab

https://www.frc.org.uk/getattachment/03838acd-facc-4a06-879c-a4682672a6d7/CRR-COVID-19-Thematic-Review-Jul-2020.pdf

https://www.frc.org.uk/getattachment/9fff0029-9be2-4cf8-8f9d-932c3689e99e/COVID-19-Resources-action-the-future_Final.pdf

https://www.frc.org.uk/getattachment/ef564f3f-d37b-4469-aa30-cc36f0343708/COVID-19-Going-concern-risk-and-viabilityFinal.pdf

Guidance with the accounting required in the financial statements for the different items that may be affected is widely available from regulators in the different jurisdictions, but also from accountancy firms and professional bodies.

Appendix

Companies in the sample

Travel
Wizz Air
Trainline
Kenya Airways
Cathay Pacific
Nigeria Aviation Handling

Leisure
Whitbread
Cineworld
Tasty
Youngs
Da Victus
C&C
Famous Brands

Non-food retail
Marks & Spencer
Burberry
Card Factory
Chow Tai Fook Jewellery
Ted Baker
The Foschini Group

Property
Land Securities

Construction
Henry Boot
Crest Nicholson
Bamburi Cement
BUA Cement
Raubex

Oil & gas
Borders & Southern
Providence Resources

Motors
Sameer Africa

Media
Nation Media

Mining

Anglo-Asian Mining

Utilities

United Utilities
Severn Trent

Telecoms

Vodafone
TalkTalk

Food

Tate & Lyle
Sainsbury's

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