

COVID-19: Mining & Oil and Gas **Part 1**



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Impact of COVID-19 on Mining, Oil & Gas Companies

The past few months have been far from ordinary. What started out as an outbreak in Wuhan, China, in late 2019 is now a global pandemic with confirmed cases in 187 of the world's 195 countries as of May 2020. While health workers are at the frontline in the fight against the pandemic, governments and businesses are also putting in place policies and measures aimed at reducing the impact of the pandemic on the economy, business operations and people.

The global economy is feeling the brunt of the pandemic. Stock markets around the world have recorded significant lows not seen before in decades. Commodity prices have responded with volatility as supply and demand are both affected by the pandemic. The interconnectedness of the world and its economy is more evident than ever, with downward revisions to growth forecasts across all countries as a result of COVID-19. Ghana, through its Ministry of Finance, has also revised the 2020 GDP growth forecast downward to 1.5% from 6.8% (Bloomberg).

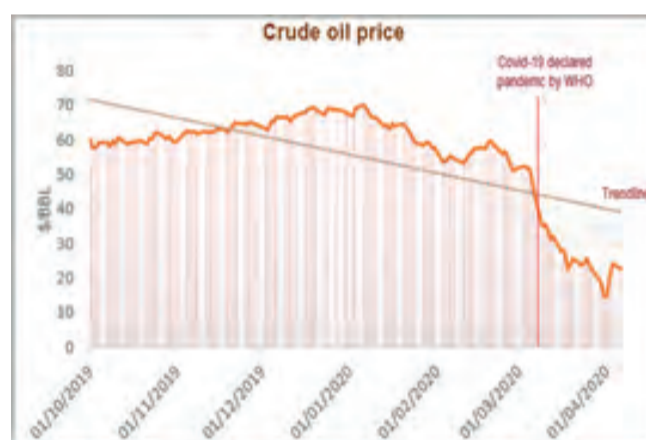
Businesses all over the world are having to deal with challenges such as price fluctuations, supply chain disruptions, continuity issues, reporting challenges, etc. This two-part article discusses the impact of these issues, triggered or worsened by COVID-19, on businesses operating in the mining and oil and gas sectors.

Impact on business operations

• Commodity price changes

The current situation has led to a sharp sell-off in energy commodity markets due to sudden drop in worldwide consumption of oil, gas and other energy related products. This has accelerated decline in oil prices and has adversely impacted on revenue and liquidity of entities in the oil and gas value chain. It is however expected that OPEC+ agreement to cut production by 10% in May and June 2020 together with the progressive easing of the restrictions currently imposed by various governments, will partly counteract the COVID-19 effects.

In contrast, after a short period of decline when COVID-19 was declared a pandemic, gold prices are back on an upward trend signifying that gold is perceived as a better store of value in these uncertain times.



Source: U.S. Energy Information Administration



Source: Kitco.com

• Supply chain bottlenecks and project delays

Due to factors like border closures and lockdowns, disruption to the supply chain is inevitable. The supply chain is impacted both by the measures in the local economic environment of the industry as well as the economic environment of the supplier, whether foreign or local, which have affected suppliers' ability to deliver the right amounts on a timely basis. Companies that may wind up as a result of the crisis will create significant gaps in the supply chain. As a result, key mining and drilling activities as well as repairs and maintenance, inspection and replacement of equipment may be delayed or suspended entirely. Already, Tullow Oil Plc has revised production targets and terminated the drilling contract with Maersk Drilling for the Maersk Venturer Drillship Offshore Ghana project.

Most mining companies on the other hand took some precautions and stocked up consumables and spares in anticipation of restrictions hence have seen minimum impact on their operations.

• Compliance issues

Entities may also face challenges in complying with regulatory requirements in the local economic environment. Governments have been proactive in assisting businesses in this regard. In Ghana, corporate income tax and employee income tax filing deadlines have been extended from 30 April 2020 to 30 June 2020. This affords companies and individuals time to prepare returns amidst activity slowdown. Although business activity continues in the mining and oil and gas sectors, companies have to consider external factors, such as the closure of refineries, that may impact sales in order to provide realistic estimates for self-assessments and minimise penalties.

The residency status of expatriates working in foreign jurisdictions may be impacted for the purpose of determining their taxable income, tax rate and tax liability. In Ghana, expatriates originally engaged for 183 days or less may now be considered as permanent residents as they are likely to spend more than 183 days in Ghana due to the current boarder closure.

• Share price volatility and market capitalisation

Global share prices of companies in the oil and gas (O&G) value chain have seen a decline mainly due to loss of investor confidence in the industry. On the Ghana Stock Exchange, however, share prices of listed oil and gas companies have not yet responded to the impact of COVID-19 with the volume-weighted average price of listed O&G companies at 4 May 2020 coinciding with the trend from 2019 Q4. In line with rising gold prices, gold stocks are also positive globally together with copper and silver.

Business continuity and cybersecurity considerations

An increase in agility is required to deal with the uncertainty the world faces today. Disruptions to business operations have resulted in entities having to trigger their business continuity and resilience plans. This requires entities to protect their employees, clients and assets with minimal disruption to business operations. Although the mining and oil and gas sectors in Ghana are largely exempted from the restrictions on movement imposed by the government, entities have had to introduce measures to reduce physical interaction among employees and other stakeholders. This has placed heavy reliance on technological infrastructure that assist in working remotely.

Start-ups in the industry which rely on parent companies or other related parties for financial support also face continuity risk. Entities that provide such support may not be able to do so anymore as a result of cash flow and other financial challenges they are likely to face.

Working remotely can be a major change for organisations but presents numerous cybersecurity risks. These risks lie in the fact that organisations have to send information over multiple networks. Cybersecurity threats must therefore not be taken lightly, and all companies must put in the necessary efforts to protect sensitive company data as well as software.

Accounting and financial reporting implications

- **Impairment of non-current assets including mining assets and oil and gas assets - IAS 36 & IFRS 6**

The determination of value-in-use of assets for impairment assessments requires that estimated cash flows from the use of assets or cash generating units (CGUs) are discounted to their present value. The current crude oil price slump will adversely affect revenues, cash flows and consequently value-in-use of assets. A thorough assessment is necessary and where required, impairment write-offs may have to be recognised in financial statements. Oil reserves could also be impacted by decreases in economic recoverability. Entities should also consider whether previously capitalised exploration and evaluation assets will be developed as planned considering current economic conditions. An entity might not be able to continue with

exploration for a number of reasons, including the inability to obtain necessary financing to continue exploration or because price forecasts are unfavourable and therefore does not support recoverability of exploration costs even if mineral ore or hydrocarbons are discovered.

- **Inventories - IAS 2**

Mining and oil and gas companies typically do not hold inventories of gas and metal (finished goods) at the end of reporting periods. Inventories usually held comprise crude oil, ore stockpiles and gold-in-process which are mostly significant to the financial statements. Aside volatility in commodity prices, production may significantly outstrip demand, or entities might experience operational issues leading to higher production costs. As a result, companies may have to write-down the cost of inventories to their reduced net realisable value.

- **Borrowing costs - IAS 23**

As the world continues to battle COVID-19, there may be delays in executing oil and gas and mining projects that entail the construction of qualifying assets such as oil and gas properties and mine properties. Companies have to assess suspension of capitalisation of associated borrowing costs of any qualifying assets that may arise in line with IAS 23 Borrowing Costs, especially when temporary delays are not necessarily part of getting the asset ready for its intended use.

- **Decommissioning obligations – IAS 37**

Changes to development and production plans, including changes to the mine life and oil production from oil reserves, might trigger changes to the expected timing or costs of decommissioning obligations and impact the measurement of such obligations. In addition, interest rates have been impacted by the current economic situation and this will likely result in changes to the discount rate applied to these obligations.

- **Depreciation of property, plant and equipment - IAS 16**

Items of property, plant and equipment are required to be depreciated when they are available for use. Depreciation is expected to be continued until an item is derecognised, even during periods where the item is idle. Entities are therefore required to recognise depreciation expense despite lost/idle time of assets due to slow down in business operations resulting from COVID-19. However, under the units of production (UoP) method, the depreciation charge would be nil while there is no production.

- **Leases – IFRS 16**

As part of measures to mitigate the effect of the COVID-19 pandemic on businesses, there has been a moratorium granted for payment of leased assets in some jurisdictions. Even though this is yet to be witnessed in Ghana on a large scale, companies would have to subsequently remeasure lease liabilities to reflect changes to the lease payments if such moratoriums are extended to them.

- **Recognition of deferred tax assets- IAS 12**

With the expected significant impact to the Companies' revenue and profitability forecasts as a result of the pandemic, entities would have to assess the probability of having future taxable profit against which deductible temporary differences can be utilised in recognising deferred tax assets. In a stricter sense, some deferred tax assets might no longer qualify for recognition.

- **Subsequent events disclosures- IAS 10**

The declaration of COVID-19 as a pandemic by the World Health Organisation (WHO) on 11 March 2020 is a non-adjusting event after reporting date for entities reporting for year ended 31 December 2019 as only a limited number of cases had been reported to WHO as at 31 December 2019.

Non-adjusting events do not result in adjustment to the financial statements, but they do require disclosure if material. This disclosure should be transparent and specific to the entity, and it should include the nature of the event (i.e. COVID-19) and an estimate of its financial effect. Entities should consider disclosing the impact of developments after the reporting date on the carrying amount of assets and liabilities (for example, the need to impair assets or remeasure fair values), or the impact on revenue or on borrowing covenants.

- **Going concern**

IAS 10 states that financial statements should not be prepared on a going concern basis where events after the reporting date indicate that the going concern assumption is no longer appropriate. This applies even if those events would otherwise be non-adjusting. Entities should therefore consider whether the outbreak of COVID-19 has any implications for the going concern assumption. Management is therefore re-required to perform a going concern assessment which should include COVID-19 considerations. Material uncertainties do not prevent preparation of financial statements on a going concern basis but require disclosure regardless.

In the concluding part of this article, I will discuss some suggestions on how to adapt to these evolving situations.

Want to know more? Let's talk.

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