In brief - Key financial reporting implications of COVID-19 on organisations in Nigeria

On March 11, 2020, the World Health Organisation (WHO) declared COVID-19 a global pandemic with Nigeria confirming its first COVD-19 case on February 27, 2020. The emergence of COVID-19 has significantly disrupted economic activities. The Federal Government of Nigeria (FGN) has had to restrict the movement of individuals and enforce the temporary shut-down of business operations, social and religious gatherings in a bid to prevent the spread of COVID-19. Subsequently, there has been a gradual and phased approach to easing the restrictions as the country and world at large observes the management of the pandemic and its effect on the economies while maintaining focus on public health.

This global pandemic has impacted industries in several ways with some industries being more vulnerable to the negative impact of COVID 19 than others. For example, industries such as the hospitality, aviation, oil and gas and entertainment to mention a few have been negatively impacted by the pandemic while others such as health care industry and its value chain, Technology/Telecommunications, Fast Moving Consumer Goods (FMCG) companies amongst others will be net gainers.

In response to this pandemic, the federal and state governments as well as the Nigeria Center for Disease Control (NCDC) have implemented various measures to curb the spread of COVID-19 in the country. The federal and state tax authorities have implemented measures to relieve some of the burdens on taxpayers. Also, regulators such as the Central Bank of Nigeria (CBN) have developed some policy measures such as the extension of moratorium and reduction in interest rate on certain facilities amongst others to cushion the impact of the pandemic. The Financial Reporting Council (FRC) of Nigeria has provided guidance to preparers of financial statements on specific issues such as events after the reporting period, going concern, effects on interim financial reporting, changes in expected credit losses for financial assets amongst others.

Even though the effects of COVID-19 are gradually phasing out and the country is on the pathway to recovery, it has become imperative for organisations to pay attention to the key financial reporting implications of COVID-19 as they remain considerations in the light of any future disruptions to business resulting in a similar economic impact.

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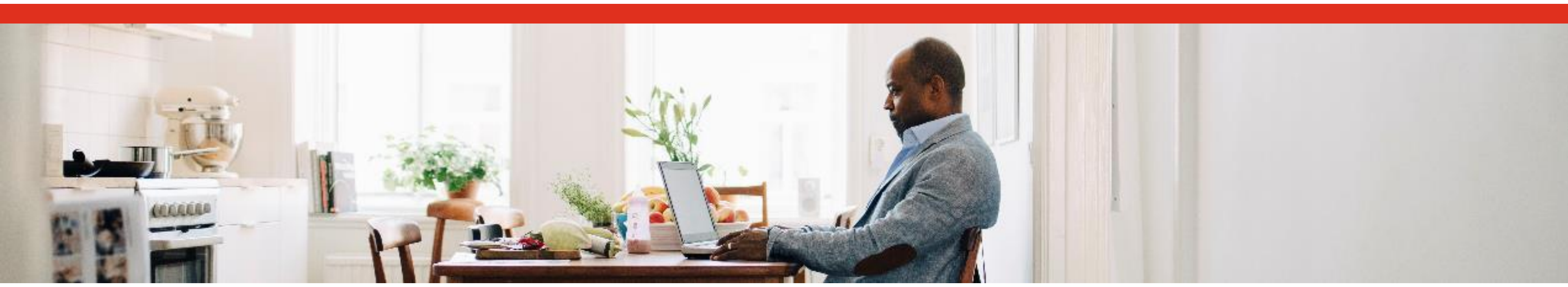

These financial reporting implications will generally be applicable to all organisations to varying degrees depending on the specific transactions obtainable in each organisation.

Item	Considerations	Actions
Inventories (IAS 2)	With the crippling of the economy due to the pandemic, many companies have experienced slow or non-existent sales which may lead to expiration, damage or obsolescence of the inventories and reduction in prices. In line with IAS 2, inventories are subsequently measured at the lower of cost and net realizable value (NRV), therefore, organisations may be required to determine the NRV of its inventories accordingly.	• Determine the NRV of inventories and recognise any write downs as appropriate. Write downs should be disclosed. • Pay attention to the value of inventories charged as cost of sales. IAS 2 prohibits abnormal losses to be charged to cost of sales.
Impairment of non-financial assets such as property, plant and equipment, intangible assets. (IAS 36)	The pandemic triggered responses from the government and institutions, which resulted in a slowdown in economic activities, and in some cases, a complete shutdown of the entity's operations resulting in idle property, a decline in demand for a company's products and consequently revenue, increase in operating costs impacting profits and fall in share prices amongst others. These events suggest that there may be an indication of impairment of non-financial assets and potentially a recognition of impairment loss in the statement of profit or loss.	• Where impairment indicators exist, companies should test for impairment: Ensure cashflow forecasts or discount rates reflect the risks arising from the impact of COVID-19. Fair values of non-financial assets and costs of disposal should be based on observable prices which reflect the current economic reality. • Consider that assets such as goodwill and intangibles assets with indefinite useful may need to be tested for impairment outside the regular annual cycle. • Reassess estimates such as depreciation methods, useful lives and residual values of the assets to ensure estimates are still appropriate. • Ensure that all related assumptions, sensitivities and other estimation uncertainties are disclosed

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Leases (IFRS 16)	Leased assets may have been left idle temporarily given the lockdown and subsequent control measures put in place. Therefore, lease contracts may be renegotiated leading to modifications to the original terms of the lease contract. Such modifications may be in the form of rent-free periods, reduction in lease payments or a change in the timing of lease payments. These modifications are likely to have an impact on the right of use asset, lease liability, interest expense and deprecation charge recognised by an entity. In line with the amendment to IFRS 16 issued by the International Accounting Standards Board (IASB) in May 2020 on COVID-19 related rent concessions, lessees have an option not to assess whether a rent concession related to COVID 19 should be accounted for as a lease modification only if the following conditions are met: • the change in lease payments results in revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change; • any reduction in lease payments affects only payments originally due on or before 30 June 2021; and • there is no substantive change to other terms and conditions of the lease, considering both qualitative and quantitative factors. A lessee that chooses to apply the practical expedient shall apply it consistently to all lease contracts with similar characteristics and in similar circumstances. The amendment is to be applied retrospectively in accordance with IAS 8, but lessees are not required to restate prior period figures or to provide the disclosure under paragraph 28(f) of IAS 8 relating to prior period figures.	• Identify COVID 19 related rent concessions and determine whether the optional exemption may be applied given the criteria. • Where criteria for optional exemption is not met, assess modifications to existing lease contracts and recognise the impact on the right of use assets and lease liability as appropriate. In assessing the modifications, note the following: i. concessions from lessors may not be considered as a modification if the modification is part of the original contract or supported by law e.g. where original lease contract provides for a force majeure event, the COVID-19 shut down may be considered as one of such events. ii. Concessions from the government may be treated as government grants in line with IAS 20. iii. Where the lessee is partially released from his obligation to make certain payments, this may result in an extinguishment of a part of the lease liability and may be derecognised as per IFRS 9 or IFRS 16. • Test for impairment of the right of use asset if impairment indicators exist. Indications of impairment may include loss of earnings during the rent concession period, declining economic performance of the asset etc.

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Revenue (IFRS 15)	With the outbreak of COVID-19, there has been a significant decline in revenue generated by many organisations as a result of a reduction in demand for products/services while many organisations within the telecommunication and entertainment industries have experienced significant increase in revenue due to the increasing demand for voice/data services and television programs. The reduction in demand may have an impact on the measurement of variable consideration as additional price concessions may be given to customers, threshold for volume discounts may be lowered to encourage patronage, there may be an increase in expected returns amongst others. These factors will affect estimates made in connection with variable consideration. In addition, with the reduction in revenue, companies may struggle to keep afloat as key performance indicators (KPIs) and financial covenants, if any, may be impacted.	• Management may need to reassess criteria for recognizing revenue due to significant changes in facts and circumstances as a result of COVID-19. In line with IFRS 15, where the customers' ability to pay for future goods and services to be delivered is no longer probable then revenue should not be recognised for the remaining goods or services to be delivered. Revenue already recognised will not be impacted, however, contract assets will be subject to impairment. • Revise estimates and cashflow forecasts made in connection with variable consideration to reflect the impact of COVID-19.
Impairment of financial assets (IFRS 9)	For many corporates, the most significant balance subject to expected credit losses (ECL) is trade receivables. However, some organisations may have intercompany or loan receivables to which the general (three staged) approach to determining ECL should be applied. To determine the ECL, IFRS 9 requires the simplified approach to be used for trade receivables without a significant financing component. The simplified approach is also commonly adopted as an accounting policy for trade receivables with significant financing component and lease receivables. It is common for organisations to use the provision matrix in implementing the simplified approach.	• Carefully analyse the credit risk drivers associated with trade receivables. • Based on the analysis of credit risk drivers, consider further segmentation of trade receivables as certain groups of customers may be more vulnerable to the effects of COVID-19 than others. Specific provisions may be required in some cases.

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Impairment of financial assets (IFRS 9) (Continued)	There is a higher likelihood that customers may fail to make payments as at when due as a result of liquidity constraints brought about by COVID-19. This will lead to a significant portion of the trade receivables balance within overdue buckets and consequently higher impairment. However, consideration should be given to the reason for delayed payments. Reasons such as operational issues rather than credit risk may mean that the level of provisions may not increase significantly. In addition, forward looking information used in determining expected credit loss rates should reflect the COVID-19 reality.	• Update forward-looking information to reflect the economic implications of COVID-19. • Disclose all related assumptions and judgements made. • There might be need to consider the extent to which the 2020 experience will be used to update the historical data of the IFRS 9 ECL model for future periods and what judgments will be applied to ensure that these do not skew the model projections where it is expected to be a one off occurrence.
Interest in associates, joint ventures (IAS 28)	Interests in joint ventures and associates accounted for under the equity method are subject to impairment in line with the requirements of IAS 28. Where an entity experiences a fall in share price and market capitalization or a significant increase in operating losses due to the pandemic, this will trigger a test for impairment.	Entities should test their interest in associates and joint ventures for impairment and effectively write down the value of their investments where appropriate.
Fair value measurement (IFRS 13)	There are multiple areas of uncertainty in the business environment as a result of COVID-19 such as the duration and severity of its effects, the timing of return to normalcy etc. The uncertainty has led to an increased level of price volatility in global markets.	• Update estimates and assumptions that are inputs into the fair valuation model to reflect current uncertainty as much as possible. • Ensure adequate disclosure on sensitivities, assumptions especially for Level 3 fair values. Avoid boilerplate repetition of disclosures as it relates to IFRS 13 as more attention should be given to the level of detail required in making the required disclosures.

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Fair value measurement (IFRS 13) (Continued)	This has an impact on the measurement of the fair value of financial assets and liabilities directly, where the fair value is derived based on market prices and indirectly, where valuation techniques based on observable market inputs and unobservable inputs are employed. Unobservable inputs such as an entity's forecasted cashflows may need to be revised to reflect the current economic situation. Fair value gains and losses are likely to exhibit greater and more frequent swings as a result of this. The fair valuations of investments in subsidiaries, joint ventures and associates are also likely to be influenced by the current market volatility. This issue will be displayed more clearly in institutions that publish financial results on a more regular basis, e.g. quarterly. Given that fair values are generally reported based on prices as at the reporting date, more reporting dates imply more chances for changes in fair value to be reflected in the financial statements. The disclosures required by IFRS 13 are quite detailed, and items like the sensitivity of profit or loss to changes in estimates and assumptions will be affected.	• More hedging instruments may be obtained in order to protect the business from severe volatilities in the profit or loss.
Borrowing costs (IAS 23)	As defined by IAS 23, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of the asset and should therefore be capitalized. Other borrowing costs are expensed. Capitalization should be suspended during periods in which active construction is interrupted.	• Where borrowing costs is incurred during extended periods of inactivity due to the pandemic, ensure borrowing costs are expensed in line with the requirements of IAS 23.

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Borrowing costs (IAS 23) (Continued)	Shut down of non-essential services (as defined in Nigeria within the context of COVID-19) has led to extended periods of inactivity. Companies are not required to suspend the capitalization of borrowing costs when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale. Temporary delays as a result of the COVID-19 pandemic is unlikely to meet this criterion as it is not a necessary part of getting an asset ready for its intended use or sale.	
Employee benefits including share-based payments (IAS 19, IFRS 2)	As a result of COVID-19, many organisations have been forced to reduce the size of the workforce or make certain payments such as health related payments for infected staff. Other organisations may have had to delay promotions, change the terms of share-based payment plans or post-employment benefit schemes. Attention should be given to any assumptions or market inputs used to determine share-based payments or employee benefit obligations and the impact of any changes in the terms of various employee benefit plans.	• Revise estimates and assumptions used to determine employee benefit obligations or share based payments to reflect the impact of the pandemic e.g. yield on corporate bonds, forecasted cashflows. Sensitivities for assumptions used should be disclosed. • Consider the need for additional liabilities to be recognised as a result of the pandemic e.g. termination benefits
Force majeure clauses	Organisations often include *force majeure* clauses in their contracts, i.e. clauses which can relieve parties of all (or specified) obligations in a contract where there are unforeseen circumstances beyond the control of the parties to the contract. The following should be considered where such clauses have been triggered as a result of COVID-19: • The impact on revenue, purchase or other arrangements (e.g. lease agreements); and • What disclosures are required in such circumstances	• Review relevant contractual agreements; Seek to understand the scope of such clauses in their contracts and how such clauses might apply in the relevant legal jurisdiction (e.g. a group with entities in various regions) • In some cases, significant judgement might be required to interpret such clauses and experts should be consulted as deemed necessary.

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Government palliatives (IAS 20)	As stated above, the government developed policies to help cushion the effect of COVID-19 on highly affected industries such as health sector, airline companies, manufacturing companies, etc. These palliatives may be treated as government grants (IAS 20).	• Assess whether the government palliatives are directly for customers or the entity. Where determined to be for the entity, account for them appropriately in line with IAS 20.
Going concern	IAS 1 states that financial statements should be prepared on a going concern basis unless management intends either to liquidate the entity or to cease trading or has no realistic alternative but to do so. Due to the pandemic, the going concern basis of some businesses have been threatened as some businesses have ceased, sales are lower, and some subsidiaries and companies are at the verge of being liquidated. Where events after the reporting date indicate that an entity is no longer a going concern, such events are always considered to be adjusting events.	• Reassess going concern assumption. In carrying out this assessment, consider the potential implications of COVID-19, measures taken by the government, and entity specific measures taken to control the impact of COVID-19. • The going concern assessment should cover the entity's prospects for at least 12 months from the end of the reporting period. If the business is no longer a going concern, financial statements should be prepared on a more appropriate basis e.g. break-up basis (use of net realisable values) • Disclose material uncertainties that might cast significant doubt upon an entity's ability to continue as a going concern.
Provisions (IAS 37)	The pandemic has triggered the need for a number of entities to materially change the scope of their businesses or the manner in which the businesses are conducted. A number of entities have considered rationalisation or closing down branches in realigning operations. As a result, entities may be required to recognise a restructuring provision in line with IAS 37 where an obligating event has occurred. Per the guidance in IAS 37, a restructuring obligation is usually constructive and arises where a detailed formal plan for the restructuring exists and those affected have a valid expectation that the entity will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.	• Consider whether the recognition criteria for a restructuring provision has been met in order to recognise provisions appropriately. • Where a restructuring provision is required, ensure that direct costs included in the provision are costs necessarily entailed by the restructuring and costs that are not associated with the ongoing activities of the entity

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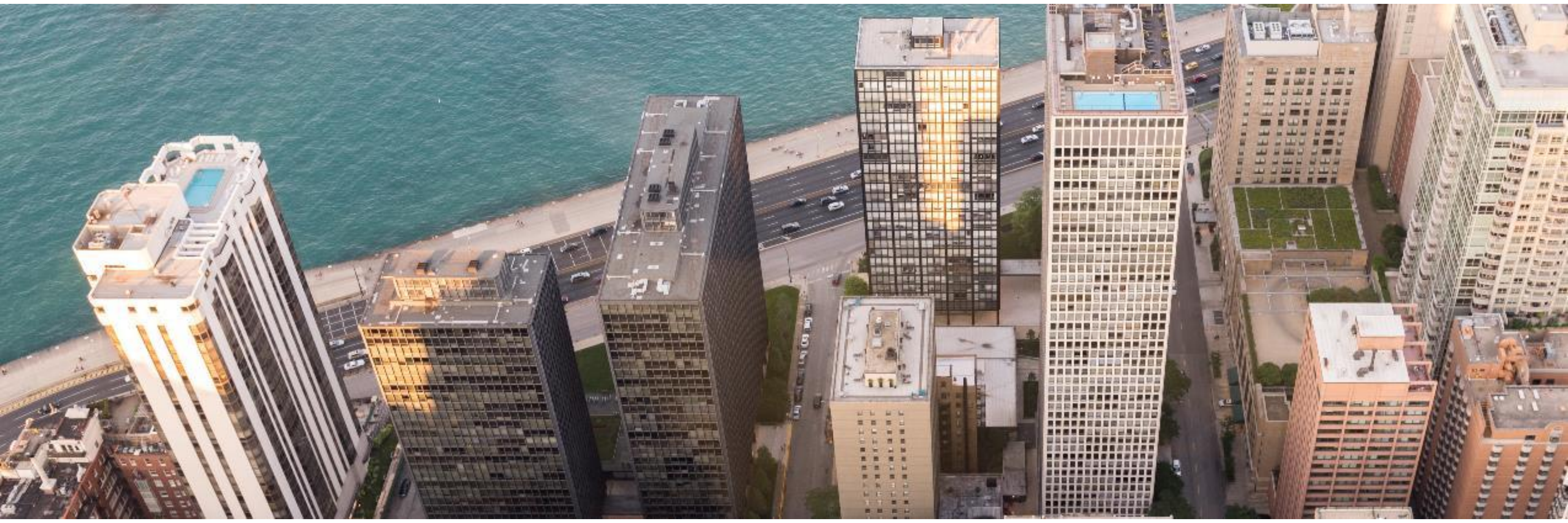
Income taxes (IAS 12)	The impact of COVID-19 in all areas mentioned above is likely to have tax implications, for example, there may be a reduction in deferred tax liabilities due to potential increase in impairment.	• Reassess recoverability of deferred tax assets and disclose significant judgement. • Consider if there are any tax reliefs granted by the relevant authorities to cushion the effects of the pandemic and ensure appropriate accounting and disclosures. • Ensure tax implications of the impact of COVID 19 on all areas mentioned are appropriately considered and accounted for.
Interim financial statements (IAS 34)	Several entities may prepare interim financial statements, therefore, the impact of COVID- 19 may first be reported in the interim financial statements. Guidance as stated in sections above should be applied in full to the interim financial statements. Interim financial information usually updates the information in the annual financial statements, however, there may be greater use of estimates in interim financial statements. Information disclosed should be reliable and relevant.	• Ensure that explanations of events and transactions that are significant to understanding the changes in financial position and performance between the date of the last financial statements and the date of the interim financial statements are disclosed. This includes the entity specific quantitative and qualitative impact of COVID-19 and measures taken to minimize it, significant judgements that were not required previously and updates to disclosures of significant estimates.



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