MALAYSIA
The Malaysian Institute of
Certified Public Accountants

TECHNICAL INSIGHTS

ACCOUNTING CONSIDERATIONS DUE TO THE IMPACT OF COVID-19

The World Health Organisation declared the COVID-19 outbreak to be a pandemic. In Malaysia, the Government is monitoring the development of the COVID-19 pandemic closely as well as taking stringent steps to contain the spread of the virus. Actions taken in response to the COVID-19 outbreak in Malaysia, especially the introduction of the Movement Control Order, have resulted in significant business disruptions and heightened economic uncertainties. Many regulators have also introduced relief measures to help revive the economy in Malaysia.

While businesses are facing negative impacts on the Malaysian economy, entities would also need to assess the impact of the COVID-19 pandemic on financial reporting. In Malaysia, most of the entities are required to limit or suspend their business operations in view of the introduction of the Movement Control Order. In fact, this poses a significant impact on Malaysian financial markets, resulting in accounting implications for many entities.

The Malaysian Institute of Certified Public Accountants (MICPA) produces this publication, aimed at highlighting key accounting issues to be considered by entities when preparing financial statements. Some of the accounting considerations include, but not limited to the following points:

Events After the Reporting Period

Though the COVID-19 occurred before 31 December 2019, the announcement by World Health Organisation that the COVID-19 is a global health emergency was made on 30 January 2020. In addition, actions taken by jurisdictions in response to the outbreak generally occurred after 31 December 2019. In fact, the effects of the COVID-19 outbreak did not have a significant impact on Malaysian market and share prices until after 31 January 2020. Hence, market participants should assess carefully based on the available information and associated risks as at the reporting date.

There is a broad consensus at the international level that the COVID-19 pandemic is a non-adjusting event for financial statements with period ended on or before 31 December 2019. Non-adjusting events refer to those that are indicative of conditions that arose after the reporting period. If non-adjusting events after the reporting period are material, entities are required to disclose the nature of the event and an estimate of its financial effect of the COVID-19 outbreak on entities, or a statement that such an estimate cannot be made. This includes a description of the impact arising from the pandemic and any actions taken by Government in response to the pandemic that have an implication to the entities' financial situations. Such entities do not need to adjust amounts recognised in the financial statements. The impact of pandemic can be reflected in the recognition and measurement of assets and liabilities in the next financial statements accordingly.

For financial statements with period ended in or after February 2020, the COVID-19 outbreak is likely to be an event that will need ongoing evaluation to find out the extent to which developments after the respective reporting date should be recognised in that reporting period. In this circumstance, entities would need to perform an analysis and assess carefully as to whether these would be adjusting events. In doing this assessment, entities should understand the fact patterns to identify events that represent the culmination of a series of conditions that existed at or before the reporting date.

Impairment of Non-Financial Assets including Intangible Assets

In addition to performing the usual impairment test at least annually on goodwill and intangible assets with an indefinite useful life following the requirements of MFRS 138 *Intangible Assets*, entities should assess whether there is any indication that assets may be impaired.

The introduction of the Movement Control Order in Malaysia to contain COVID-19 pandemic may have caused the decline in demand, the disruption of supply and the decline in commodity prices. These might have created indicators of impairment, for example, entities plan to terminate their operations due to the impact of pandemic; entities plan to restructure their operations to which an asset belongs after the period of Movement Control Order; an asset becomes idle after the period of Movement Control Order; entities plans dispose an asset at a loss in a distress market. Please be reminded that MFRS 136 *Impairment of Assets* requires entities to perform an impairment test (i.e., estimate the recoverable amount of the affected cash generating unit) as and when there is an indication that the asset or cash generating unit may be impaired.

In addition, with the introduction of the Movement Control Order, retail stores and shopping malls are facing significant reduction in consumer traffic and may result in permanent closures. Impairments to right-of-use (RoU) assets would happen as a result of permanent closures of businesses and disruption of supply chain. This would affect the future cash flows expected to be derived from the use of the underlying asset. RoU assets that measured using a cost model, should be carried at cost less any accumulated depreciation and any impairment losses. Simultaneously, it should be adjusted for the lease liability. Such impairment is assessed under the requirements of MFRS 136 *Impairment of Assets.*

Assessment of Expected Credit Losses

The effects of COVID-19 pandemic on businesses' financial performance may affect their customers' ability to meet scheduled repayments. Loans have higher probability of default and security value may have declined. Under this challenging and rapid changing time, the challenge for entities to measure their expected credit losses (ECLs) is to the determine the forward-looking information relating to the economic impact of COVID-19 that is available without undue cost or effort at the reporting date. The COVID-19 outbreak is having severe economic impacts across many jurisdictions. In Malaysia, drop in forecast of economic grow, increase in unemployment rate and fall in security recoverable value, amongst others, would increase the probability of default and loss given default. Entities should update the forecasts of economic growth in their measurement of ECLs at the reporting date by including the reasonable and supportable information available at that time. The extent of information and effort will depend on the entities' exposures.

Entities may consider the following factors when estimating ECLs:
- Given the Central Bank Malaysia provided measures to mitigate the impact of the COVID-19 pandemic on financial institutions, entities should consider this when measuring ECLs;
- Some industries may be severely affected by the economic effects of the COVID-19 pandemic. Entities with exposure to customers in these industries should consider the

appropriateness of measurement of ECLs by taking into account of the conditions of their customers;
- Borrowers may draw down credit facilities to help them weather the economic effects of the COVID-19 pandemic. Entities should estimate this exposure in relation to the increase in loan commitments;
- Typically, ECLs are measured using past trends to derive links between changes in economic conditions and customer behaviour. The parameters such as probabilities of default, loss rates and loss given default. Under the crisis time, these relationships will not be easily established. In this circumstance, entities may want to adjust the results, based on expert credit judgement to reflect the information available at the reporting date;
- Other considerations that mentioned in MFRS 9 *Financial Instruments* include:
  - the expected cash flows used in measuring ECLs may have affected by change in entities' plans;
  - the economic uncertainty impacted on credit losses may warrant entities to consider additional economic scenarios when estimating ECLs; and
  - limit increases for credit cards may be taken into consideration when measuring ECLs.

For disclosure, entities should disclose the nature and extent of risks in relation to the impact of the COVID-19 arising from financial instruments and how it manages those risks.

Fair Value Measurement

Pursuant to MFRS *13 Fair Value Measurement*, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal market at the measurement date under current market conditions, i.e. an exit price, regardless of whether that price is directly observable or estimated using another valuation technique. At this unprecedented and rapidly changing time, fair value measurement, for example, measurement on financial instruments and investment properties, depends on the seriousness of the COVID-19 pandemic at the reporting date which impacted on market participant views and market data at that date. Accordingly, entities should evaluate the fair value of an asset or a liability using the assumptions that market participants would use when pricing the asset or liability under the market conditions. The information available to the market participants at the reporting date may be relevant in making this evaluation. Entities should pay attention to fair value measurement based on level 3 unobservable input and ensure that this unobservable input used reflect how market participants would reflect the effect of the COVID-19 pandemic in the future cash flow in relation to assets or liability at the reporting date. To meet the disclosure objectives of MFRS 13 *Fair Value Measurement*, disclosure of the fair value measurement should reflect the effect of the COVID-19 pandemic on the measurement of fair value, aimed at enabling users of the financial statements to understand the basis for the inputs used in fair value measurement.

Valuation of Inventories

Under this unprecedented and rapidly changing waters, the pandemic may have impacted on the recoverability of inventory. Entities should assess as to whether a write-down for obsolescence or slow-moving inventory is needed as a result of lack of sales. In addition, entities should also assess as to whether there is a potential drop in selling price. In this circumstance, entities should write-down their costing of inventories.

Simultaneously, entities would need to scrutinise the measurement of their inventories at the lower of their cost and net realisable value (NRV) following the requirements of *MFRS 102 Inventories*. In an economic crisis environment, entities would need more detailed methods or assumptions for calculating the NRV. Inventory impairment losses should be recognised in the period in which they occur and subsequent recoveries should be recognised as gains accordingly in the period in which they occur.

In the case of manufacturing entities, these entities may be affected by the pandemic in a number of ways, such as unplanned factory downtime and shortages of labour and materials due to introduction of the Movement Control Order. Such abnormal loss would have impacted on the costing of inventories. Hence, such abnormal loss should be expensed to profit or loss. If products are perishable or with shorter shelf lives, such products would be exposed to the risk of loss. Hence, entities would need to review their costing of inventories to unallocated fixed overheads are captured in correct accounting period.

Going Concern

Entities are regarded as going concern unless board of directors either intends to cease the operation or liquidate the entities. The responsibility lies with management to assess the ability of the entities to continue as going concerns at this challenging time. Whilst management performs an assessment to determine as to whether the going concern assumption is appropriate, management should take into account all available information about the future, which is at least, but is not limited to, twelve months from the reporting date. Given the rapidly changing nature of the COVID-19 pandemic, preparation of detailed cashflow forecasts would be expected and updated until the financial statements are authorised for issuance. These forecasts should reflect management's plans as a result of impact of the pandemic on the business.

The impact of pandemic on customers, suppliers and employees should also be considered. For example, could an entity continue its operation if employees were not able to physically be present, and how long could the entity survive given the availability of working capital? When management is aware of material uncertainties that cast a significant doubt on the entity's ability to continue as a going concern, the entity should disclose those material uncertainties in the financial statements. In fact, the impact of the pandemic has led to a significant deterioration in economic conditions for many companies. Shortages of cash flows may result in a breach on loan covenants. A breach of loan covenants after the reporting date is a non-adjusting event. A breach after the reporting date could also affect the entity's ability to continue as a going concern. If the information is material, this should be disclosed in the notes to financial statements.

Other Areas

Entities should also watch out other areas in financial statements that might be affected by the COVID-19 pandemic, including:

- Breach of Loan Covenants. Risk that entities contravene loan covenant is higher at this unprecedented challenging time. Entities should assess how the contravention of a loan covenant would impact on the liabilities of the entities and the presentation of liabilities at the reporting date.
- Onerous contracts pursuant to MFRS *137 Provisions, Contingent Liabilities and Contingent Assets;*
- Recoverability of deferred tax assets pursuant to MFRS 112 *Income Taxes;*
- Variable consideration pursuant to MFRS 15 *Revenue from Contracts with Customers;*
- Restructuring plans. Entities consider restructuring plans such as the closure of part of its businesses in this challenging time as a result of the pandemic;
- Management of liquidity risk. For example, entities use alternative sources of funding to manage liquidity risk, i.e. arrangements with financial institutions, arrangements with suppliers and etc;
- Reorganisation of operations. For example, entities recognise termination of employee benefits as result of reorganisation of operations i.e. reduction in workforce;
- Change in contractual arrangements. For example, a rent free or a reduction or deferral of lease payments granted by a lessor to a lessee pursuant to MFRS 116 *Leases.*

Ongoing Efforts

Under this unprecedented and rapidly changing time, entities should evaluate the above-mentioned accounting issues when fact patterns change.