IMPACT OF COVID-19 ON FINANCIAL REPORTING IN THE PUBLIC SECTOR IN SOUTH AFRICA

The outbreak of Coronavirus disease 2019 (COVID-19) is having a widespread impact on the global economy. The virus has taken its toll on not just human life, but businesses and financial markets too, the extent of which is currently indeterminate. Entities (public and private sector) must carefully consider their unique circumstances, risk exposures and consider the impact the outbreak may have on their financial/accounting reporting. Specifically, financial reporting and related financial statement disclosure need to convey all material effects of COVID-19.

The further development, duration and impact of the coronavirus cannot be predicted. Entities also need to know that global responses to the coronavirus disease 2019 (COVID-19) outbreak continue to rapidly evolve and these responses will continue to have an impact on all business entities, private or public sector.

This article identifies some of the key financial reporting areas that entities (the focus being on the public sector entities) need to consider and focus on when determining the impact COVID-19 is having on their business, and on the results, financial position and disclosures in their preparation of the 2020 financial statements. This is not an exhaustive list and there may be other areas not included in this article that entities should consider as the impact will differ from one entity to another, and entities, and their auditors, have to consider the effects of the virus on their business and review them regularly. It should also be noted that these areas that are discussed have not been listed in any order of importance.

Some of considerations as to the impacts of the COVID-19 on AFS, we have those into these 3 categories:

1. Financial Statements Components (Balances)
2. Disclosures and Subsequent events
3. Other General Issues or considerations

Below is the detailed discussion of each of the above categories.

Part A: Financial Statements Balances

Below are some of the issues/risks that entities will need to factor in as part of COVID-19 impact as they prepare their Annual Financial Statements:

- Defined Employee Benefit Obligations/Liabilities
- Government Grants and Donations
- Fair Value Measurements
- Impairment of Receivables
- Leases
- Onerous Contracts
- Revenue
- Employee benefits and Accrued Annual Leave
- Capital projects (Work-In-Progress)

Defined Employee Benefits Obligations/Liabilities (Pensions and Post-Retirement Plans)	At the end of each reporting period entities obtain the actuarial valuations of their Defined benefit plan liabilities which would be the aggregate of the present value of the defined benefit obligation and unrecognised actuarial gains and losses, reduced by unrecognised past service costs. This is in terms of GRAP requirement to determine the present value of defined benefit obligations and the fair value of plan assets at the end of each reporting period. Measuring a defined benefit obligation involves making estimates and the use of assumptions (e.g. the use of appropriate interest rates, future salary increases and employee turnover). The current significant economic uncertainty i.e. the sudden fall in markets, associated with the COVID-19 pandemic will affect the measurement of defined benefit obligations and plan assets. This market volatility and changes to the remuneration policies, will impact how the entities will estimate and measure the defined employee benefits at year end. Accounting officers should disclose the changes in estimates and assumptions resulting from the impact of COVID-19. Entities always involve a professionally qualified actuary in measuring such obligations and these experts will be needed in assessing the impact these uncertainties have on the defined employee benefits liabilities. Actuaries will need to assist management in determining if COVID-19 has had an impact on the assumptions and estimates that they used in the reports and any changes in the estimates or assumptions will need to be disclosed.
Government Grants and Donations	Entities need to monitor government actions to identify all assistance given amid COVID-19 outbreak that may meet the definition of a Government Grant. Government programmes may be introduced to assist with the fight against the spread of the virus and this form of assistance needs to be recognised and disclosed as part of financial reporting. The assistance can also be in the form of donations which are not in monetary form, that would need to be disclosed in the AFS. Entities should disclose the nature and extent of the government grants recognised and provide an indication of the other form of government assistance from which it has benefited. Any unfulfilled conditions and other contingencies attaching to the government assistance should also be disclosed in the financial statements.
Fair Value Measurements	The Fair value of an asset (or liability) is determined as per the market conditions as at the measurement date. The Fair value measurements (such as those involved in measuring, for example, certain financial instruments and investment properties) should reflect market participant views and market data at the measurement date under current market conditions. The fair values can be determined by the observable market prices or through the application of valuation techniques. Due to the uncertainty in the market

	(decline in financial and property market prices i.e. the market being a buyer's market) due to COVID-19, there would be a significant change in the assumptions used to measure fair value of the assets and liabilities at the end of the reporting period including considerable change in the valuation techniques to account for the change in the market conditions and related observable inputs, redundant previous information, etc. Appropriate disclosures on these changes of estimates and assumptions would need to be made in the reporting entity's financial statements. Management need to engage their experts that they use in determining the fair values to assist in their disclosure of the key assumptions and judgement that have been impacted by the pandemic. Entities will need to pay particular attention to fair value measurements based on unobservable inputs and ensure that the unobservable input used reflect how market participants would reflect the effect of COVID-19, if any, in their expectations of future cash flows related to the asset or liability at the reporting date. There may be an increase in the amount of subjectivity involved in fair value measurements, especially those based on unobservable inputs. In some cases, greater use of unobservable inputs will be required because relevant observable inputs are no longer available. The valuation experts using the valuation techniques will need to take into account the impact of COVID-19 on assumptions such as the discount rates, credit risk, etc.
Impairment of non-current assets	All entities are required to assess, at the end of each reporting period, whether there is any indication that non-financial assets may be impaired. The impairment test only has to be carried out if there are such indications. If any such indication exists, the entity shall estimate the recoverable amount of the asset. Entities may need to assess whether the impact of COVID-19 has led to an asset impairment due to the contraction in economic activity due to the outbreak of the pandemic that can be considered as an impairment indicator. Non-current asset's financial performance, including estimates of future cash flows and earnings, may significantly be affected by the direct or indirect impacts of recent and ongoing events economic events. Indicators of impairment include (but are not limited to) significant changes with an adverse effect on the entity that have taken place during the period, or will take place in the near future: • Market or economic environment in which the entity operates; and • Extent to which, or the manner in which, an asset is used or is expected to be used (for example, an asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, plans to dispose of an asset before the previously expected date) As a result of the impact of COVID-19, entities may need to perform an impairment assessment of certain assets.

Impairment of Trade Receivables	Entities such as Municipalities are likely to be affected as the negative impact of COVID-19 is being passed on to its consumers. There is an increased risk of default as many some consumers such as companies are likely going to struggle to survive this period of uncertainty. Individual who are residential consumers also have increased risk of unemployment. As a result of this uncertainty of the economy there is an increased risk that Municipalities and Municipal entities will face cash flow issues. Expected future cashflows will be impacted which will also affect the calculation of impairment. The recoverability of trade receivables will be a huge issue and this might result in high non-payment rates for the services such as electricity, water, refuse, sewerage, etc. The other challenge that the Municipalities will face is trying to estimate the future cash flows due to the increased economic uncertainty imposed by the COVID-19 virus.
Leases	As part of some relief measures, lessors and lessees can agree to modify the lease agreements such as 3 months' payment holidays similar to those being provided by the banks. These modifications will need to be considered by the preparers of the financial statements including determining whether such modifications are new lease agreements or just modifications. Recent Reserve Bank repo rates cut are also going to impact those lease agreements that have an interest rate linked to for example the prime interest rate. Entities will also need to determine whether as a result of COVID-19, any lease arrangement has become an onerous contract (Refer to below).
Onerous Contracts	An onerous contract arises when the unavoidable costs of meeting the obligations under the contract exceed the benefits expected to be received. Contracts may become onerous, if for example, the suppliers are unable to fulfil their obligations under the contract as a result of closure during the lock down periods which as a result would necessitate the recognition of a provision. Delay in the fulfilment of contractual obligations may also result in penalties to be provided for. Municipalities and Municipal entities need to provide the disclosures about the judgements and the estimates applied in recognising and measuring provisions from an Onerous contract.
Revenue	The economic contraction as a result of COVID-19 is having a direct impact on the market values of properties that directly impact the Property rates revenue of Municipalities and municipal entities. According to property experts the current economic conditions make it a buyer's market and as a result the values of properties are likely to be reduced and be favourable to the buyers. These reduced market values will have a direct impact on the Property rates revenue. Interest income from investments that have an interest rate that is linked to the prime interest rate will decrease due to the recent announcements to reduce the repo rates.

	Revenue of entities will also be negatively affected by the lock down period as a result of the social distancing measures. Municipal community assets that are rented out to the general public to earn revenue will not have the usual booking of events due to the limitations on the number of people that are allowed to gather for events. Activities such as taking meter readings and delivering of statements will be impacted during the lock down as they might be considered not to be essential services.
Employee benefits and leave provisions	Some entities may in response to the COVID-19, offer additional benefits to its employees. If these are new employee benefits, then the entities will need to determine how they will be accounted for during the preparation of the financial statements. The entities can also provide some kind of support to its employees for example those under the mandatory quarantine while they are sick. These financial supports or benefits are likely to meet the definition of a liability; and an expense and the liability will need to be recognised. Employee accrued leave provisions will be affected if the employees are forced to make use of their annual leave during the lock down period. Public officials have also been volunteering to pay one third of their salaries to the Solidarity Funds and entities will need to determine how they will account for these monies in the financial statements.
Capital Projects (Work-In-Progress)	During the lock down period all the construction taking place on capital projects might be halted resulting in delays in the completion of work in progress projects. GRAP requires entities to disclose why capital projects took a longer period to complete than they were scheduled and the impact of COVID-19 on entities might result in these delays that need to be disclosed. This will also affect the Unspent conditional grants at year end i.e. the non-completion of projects where the Municipality has already received the funds.

Part B: Disclosures and Subsequent Events

Below are some of the disclosure items that need to be considered by the preparers of the financial statements:

- Events after the end of the reporting period
- Material judgements and uncertainties
- Breach of covenants
- Going concern

Capital Projects (Work-In-Progress)	During the lock down period all the construction taking place on capital projects might be halted resulting in delays in the completion of work in progress projects. GRAP requires entities to disclose why capital projects took a longer period to complete than they were scheduled and the impact of COVID-19 on entities might result in these delays that need to be disclosed. This will also affect the Unspent conditional grants at year end i.e. the non-completion of projects where the Municipality has already received the funds.

Events after the end of the reporting period (subsequent events)	At the end of each reporting period, entities should carefully evaluate information that becomes available after the reporting date but before the issuance of the financial statements. The amounts in the financial statements must be adjusted to reflect events that provide evidence of conditions that existed at the end of the reporting period. Additionally, if non-adjusting events (those that are indicative of conditions that arose after the reporting period) are material, an entity would be expected to disclose the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made. Entities would need to consider whether the financial reporting effects of the COVID-19 outbreak should be accounted for as an adjusting or non-adjusting events after the reporting date through using management judgements in some cases. For instance, estimated effects of impairment of financial and non-financial assets (considering events and new information arising after the reporting date), covenant breaches, amendments or waivers in lending agreements, losses due to supply chain issues, etc.
Material judgements and uncertainties	When reporting in uncertain times, it is particularly important to provide users of the financial statements with appropriate insight into the risks and uncertainties facing an entity and the judgements that have been made in preparing financial information. Depending on an entity's specific circumstances, each of the areas discussed in this publication may be a source of material judgements and uncertainties that requires disclosure applying IAS 1 Presentation of Financial Statements. Where this is the case, the entity should provide disclosures, distinguishing between • Significant judgements i.e. judgements other than estimations made in applying an entity's accounting policies, often in how an item is characterised; and • Significant sources of estimation uncertainty i.e. assumptions or other sources of estimation uncertainty (including judgement involving estimation)
Breach of covenants	Unstable trading conditions and shortages of cash flows due to reduced cashflow collection may increase the risk that entities breach financial covenants. Entities should consider how the breach of a loan covenant would affect the timing of repayment of the related loan and other liabilities (e.g. it becomes repayable on demand) and how it affects the classification of the related liabilities at the reporting date. If a breach occurs on or before the end of the reporting date and the breach provides the lender with the right to demand repayment within 12 months of the reporting date, the liability should be classified as current in the entity's financial statements in the absence of any agreements made prior to the reporting date that give the entity a right to defer payment beyond 12 months after the reporting date. In contrast, a breach of loan covenants after the reporting date is a non-adjusting event that should be disclosed in the financial statements if the information is material. A breach after the reporting date could also affect the entity's ability to continue as a going concern.

Going concern	Financial statements are 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. The assessment as to whether the going concern basis is appropriate takes into account events after the end of the reporting period. 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. Many debtors that are consumers for the entities such as the Municipalities and Municipal Entities are facing the risk of not being able to continue as a Going concern due to the impact of COVID-19. As a result, there is an expectation of reduced collection rates by the Entities. National government is also going to withhold or re-allocate some of the grants especial capital conditional grants. For some State Owned Entities, government will stop bailing them out due to funds being prioritised for health e.g. the SAA business rescue practitioners were not provided with their R 10 billion of bailout money that they had requested resulting in doubts in its ability to continue as a going concern.

Part C: Other General Conditions

Below are some other considerations that also need to be kept in mind by the preparers:

- Circular 100 has been issued by National Treasury to assist with compliance of SCM regulation during this COVID-19 period when a Municipality has to procure items to help in the fight against the spread of the virus. Municipalities will need to make use of this regulation to guide them on procuring emergency items to combat COVID-19. This circular has been issued to limit Irregular expenditure.

- There can be transfer of functions between government entities/spheres during this period for example National Government decentralising some of its functions to the provincial government. This can result in Principle VS Agent arrangements.

- Entities also need to consider if their initial budget estimates are still relevant. For Municipalities the budget processes for the 2021 financial period might already be getting delayed as a result of the local down period and social distancing measures i.e. limiting gatherings of 50 people. Public participation on the budget had to be done by the end of March and the lock down made this task impossible for municipalities. Special budgets might to be done my Municipalities in order to budget for some projects that can be needed in order to respond to the pandemic.

- National Treasury has given an extension to the PFMA entities on the period on which they can submit their financial statements. Since the PFMA entities now have until the end of July to submit the financials, this will also affect the period that MFMA entities will need to submit theirs due to the audit that will need to be completed first of PFMA entities.

Conclusions

Disclosures will need to be done in the AFS to assist the users understand the degree of uncertainty associated with management's assumptions about the future. Therefore, robust disclosures should be expected in the financials to help the users understand the degree of estimation uncertainty that went in estimating the recoverable amount and to possible changes in the key management/expert assumptions. Entities will also need to consider the impact of COVID-19 on its accounting policies.

Although this article provided some insights, entities will need to regularly consider and reassess the impact of COVID-19 on their service delivery, clients, transactions, balances, policies and procedures. As countries on a daily basis address the reality of the COVID-19, so will public sector entities need to react on a daily basis to the challenges brought by it.

We shall recover. We shall overcome – Pres Cyril Ramaphosa

For more information or support on the above or any other public sector accounting, financial management or governance matters, please give us a call or send us an email.

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