SNG Grant Thornton

Collaborative

Quality

Global

The Impact of Unrest: Financial Reporting and Disclosures

Assessing the financial impact and required disclosures

Civil unrest has undoubtedly had an impact on almost all entities either directly or indirectly, it generally heightens our awareness to volatile situations, and highlights the uncertainty engrained in developing economies and young democracies.

Civil unrests are not unique to developing countries and in most recent months, we saw the Hong Kong civil unrests and demonstrations in the United States of America, not excluding other civil movements experienced globally. The recent unrest experienced in South Africa and Eswatini has had a significant impact on families and businesses, casting a spotlight on the realities of society in the throes of a Pandemic as well as financial and political challenges. We are yet to understand the full impact on our economy but from what we know, the recent unrests have taken its toll on not just human life, but businesses, financial markets and breadwinners alike too, the extent of which is currently indeterminate. Entities need to carefully consider the accounting implications of this volatile situation.

Some of the worst hit sectors are investment property sectors specifically shopping centers, warehouses and factories, logistics and distribution sectors, food and beverages sector, and informal traders. Although some entities may not be severely impacted, very few entities will remain unaffected.

Even if the entity does not see a direct impact of the unrest, either because of its geographical footprint or as a result of the successful safeguarding of assets in affected areas, there will be an indirect impact for practically all entities within South Africa, and its neighboring countries.

This guide should be read together with **the following:**

- **Reset, Refocus, Reignite your business**
- **Looting: Tax Considerations**

Changes in the economic environment in which entities operate are likely to result in changes to management's operating plans, its strategic initiatives or future endeavors. Such information is likely to be useful to investors, lenders, creditors and other primary users of financial statements, and could possibly create a demand from users of financial statements for managers to provide up to date information more regularly.

To determine the disclosures required, entities need to consider the financial impact on the entity as a whole, including the industry in which it operates. This guidance identifies key financial reporting areas that entities need to consider when determining the impact on their business, and on the results, financial position, and disclosures in their financial statements. The objective of this guidance is not to create a burden on the preparer to change the volume of disclosures, although that might be the consequence, but rather to focus on presenting relevant information in a manner that promotes the integrity of the financial statements prepared.

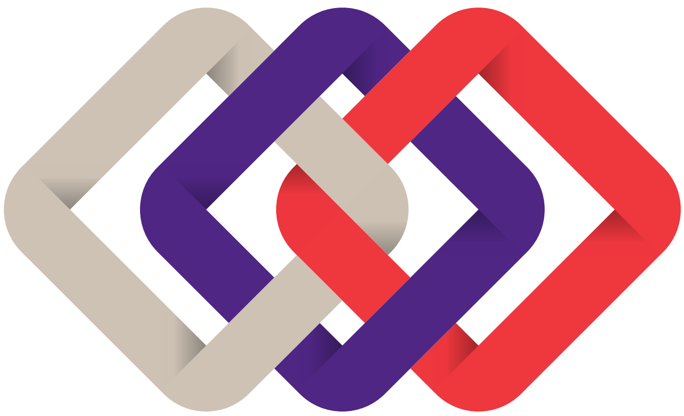
This guide is not intended to be an exhaustive list and there may be other areas not included in this document that entities should consider. The areas are not listed in order of importance.

What disclosures need to be made in the financial statements

The decision on whether information is likely to be relevant to the users of financial statements is a dynamic assessment taking into consideration the magnitude of the events, the entity's geographical location, industry sector, and the state of the economy in which the entity operates.

Uncertain economic environments also influence the measurement of certain items in the financial statements, making those estimates more challenging, over and above those uncertainties related to the impact of the Pandemic. An unexpected variation or unexpectant change in estimates, even if quantitatively immaterial might be considered material due to the nature of these events, and the expectation on management to be transparent in their assessment of the impact of unrest on the financial statements. Disclosure is key in promoting transparency, and therefore entities should supplement rigor in assumptions, estimations and material judgements, with disclosure. The recent unrests have been widely documented and fiercely debated in local news, presidential addresses and media briefings. The public availability of information does not relieve an entity of the obligation to provide such information in its financial statements.

It is important therefore that an entity considers not only the specific disclosure requirements relating to individual items of the financial statements, but also the overarching disclosure requirements in IAS 1. These requirements include those in paragraph 122 relating to judgements that have the most significant effect on the amounts recognised in the financial statements, paragraph 125 relating to major sources of estimation uncertainty and assumptions about the future, and the possible impact of the ability of the entity to continue as a going concern.



Preparers should also consider the importance of management commentary as the information about the unrest and the impact thereof presented from management's perspective provides useful context for the financial statements. The inclusion of forward-looking information of the macro-economic environment in which the entity operates, as well as management's plans to recover from the unrest within management commentary helps users of the financial statements determine whether the unrest would have a lasting impact or future performance of the entity. For preparers that produce integrated and sustainability reports, the unrest needs to be clearly explained together with its impact on the various capitals over the short, medium and long term; that underpin the business model.

Judgements and estimates

We remind preparers of financial statements of the disclosure requirement in IAS 1 paragraph 122 about those judgements, apart from those involving estimates, that management has made in the process of applying the entity's accounting policies. Such judgements would become evident as entities start counting the costs of looting and navigating the aftermath of these unrests.

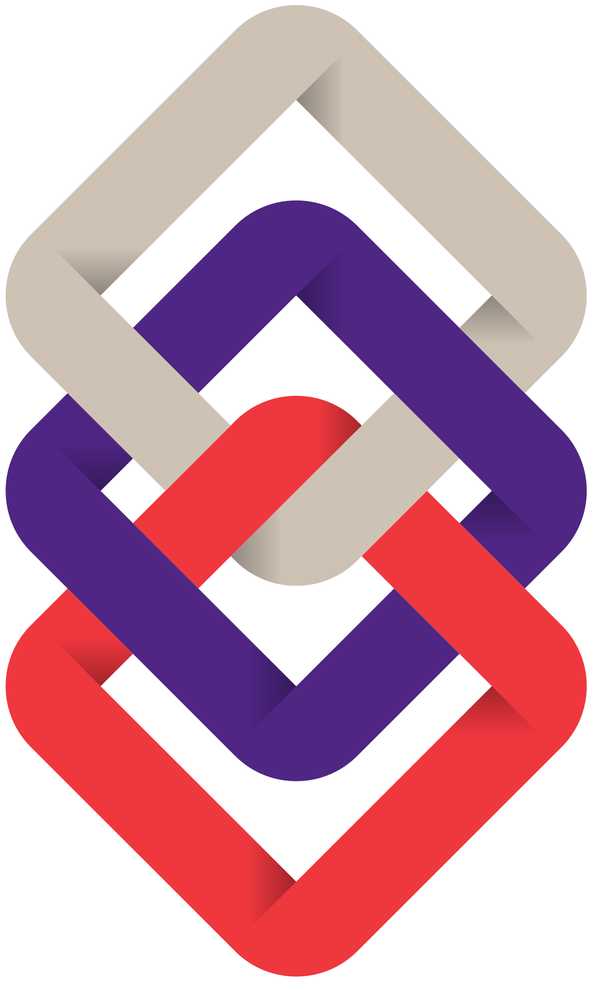
By example, where goods and services have been or are being rendered to customers who are either based in geographical areas impacted by the unrests or significantly impacted by it, entities will need to assess whether collection of outstanding balances is probable while evaluating *new* contracts. In the absence of such probability, companies may not be able to recognise revenue until or unless payment is received and becomes non-refundable, because such contracts are unlikely to meet the criteria to apply IFRS 15 until such time the uncertainties are resolved.

Other existing contracts might become less profitable or onerous when for example, an entity might face penalties as a result of delays to deliver its goods to affected areas either due to logistical challenges or incur increased costs that cannot be recovered when finding alternative suppliers. Management needs to consider whether any contracts are in an *onerous* position and whether a liability needs to be recognised.

When disclosing these judgements, users want to understand the judgements involved and make their own assessment of future outcomes. Users may also want to be able to compare the impact of unrests between entities operating in the same geographical location or operating in the same or similar industries.

Similarly, when disclosing estimates and assumptions in accordance with IAS 1 paragraph 125, users expect entities to base their estimates on assumptions consistent with management's expectations of the operating environment, and the impact of any disruptions to the business performance at the reporting date. These assumptions should be unbiased and based on the best available and reasonable supportable information available at the time. We caution preparers and users alike in using the benefit of hindsight in making these assumptions. Assumptions need not be perfect, but rather well-reasoned and supported with appropriate oversight from the audit committee or board of directors.

In almost all instances, fair presentation is achieved when additional disclosures are provided when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of events and conditions on the entity's financial performance and financial position at the reporting date.



Going concern

Most preparers are familiar with the specific discussion of going concern and related disclosure requirements in IAS 1 paragraphs 25 and 26 relating to an entity's ability to continue as a going concern. IAS 1 explicitly states that at each reporting date, management is required to assess the entity's ability to continue as a going concern and consider all available information about the future, which is at least, but is not limited to, twelve months from the annual reporting date.

The IASB recently cast the spotlight on the assessment of going concern in its document Going concern—*a focus on disclosure* issued in January 2021. In this document, the IASB emphasises that management should consider a wide range of factors, including current and expected profitability, debt repayment schedules and potential sources of replacement financing and the ability to continue providing services. The ability of the entity to continue providing services could be severely impacted by the recent lootings. This should also be considered if for example, the entity is reliant on subcontractors or agents stationed in geographical areas affected by the unrest who can no longer provide these services to the entity's customer base.

The IASB in the above-named document, further notes that even if, after considering planned mitigating actions, such as access to alternative subcontractors or agents, management's conclusion is that there are no material uncertainties in its ability to continue as a going concern, those conclusions reached involves significant judgement, and the disclosure requirements in paragraph 122 would apply. If there is material uncertainty about the entity's ability to continue as a going concern, the entity should include extensive going concern disclosures in the notes to its financial statements.

The assessment regarding an entity's ability to continue as a going concern covers the period no less than twelve months from the annual reporting date, therefore all events that occur during an entity's subsequent events period should be considered when evaluating whether there is significant doubt about the entity's ability to continue as a going concern. In other words, even if events of unrest and looting happened during the subsequent events period and are not considered adjusting subsequent events, they should still be incorporated into the going concern assessment.

Subsequent events

In accordance with IAS 10 *Events after the Reporting Period*, entities are required to distinguish between subsequent events that are adjusting (i.e., those that provide further evidence of conditions that existed at the balance sheet date) and those that are non-adjusting events (i.e., those that are indicative of conditions that arose after the reporting date). We remind preparers of the commonly used, but very relevant example in IAS 10 paragraph 22 where the destruction of a major production plant by fire after the reporting period would result in disclosure as a non-adjusting event. In contrast, IAS 10 paragraph 9 provides the example of where a customer is bankrupt, or in a South African context, would enter business rescue proceedings after the reporting date, it would usually confirm that the customer was credit-impaired at the end of the reporting period and would therefore be accounted for as an adjusting event.

Whilst we acknowledge that bankruptcy as a result of destruction of property or looting could "push" a struggling entity over the edge and in those instances the loss indicators were present at the reporting period, we caution preparers to consider the facts and circumstances of these events on a case-by-case basis. Instances where a customer might not have SASRIA or an equivalent insurance policy, appropriate back-up systems or where its own supply chain has been severely disrupted, could lead to bankruptcy as a consequence of the unrest experienced. Such events were not present at the reporting date nor does it confirm a credit-impaired position at the reporting date. Management's judgements in this regard should be disclosed where those judgements have a material impact on the financial statements presented. All disclosures should be entity-specific and include information relevant to their circumstances.

For ease of reference, our observations in determining whether these unrests experienced in South Africa and Eswatini are adjusting, or non-adjusting events are set out below.

South Africa

1. Adjusting event – year end on or after 31 July 2021.

The civil unrest experienced in South Africa happened early July 2021 therefore, for financial reporting periods ending on or after 31 July 2021, the civil unrest events would generally be adjusting events and would require the assets and liabilities to be adjusted to take into effect any accounting implications associated with or caused by events related to the civil unrest.

2. Non-adjusting – year end on or before 30 June 2021

An entity shall not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the reporting period (IAS 10 paragraph 10). For entities with reporting periods ending 30 June 2021 and before this will constitute non adjusting event and entities will need to disclose the nature of the event and the estimate of its financial effect, or a statement that such estimate cannot be made in accordance with paragraph 21 of IAS 10.

Eswatini

Due to violent escalation of these unrests, from what was observed as seemingly peaceful protests in June, entities in Eswatini should carefully consider the application of IAS 10 to the events and circumstances present at its reporting period.

Capital maintenance

Many entities affected by looting and damage, facing significant cash flow constraints may decide not to declare dividends in an attempt to stabilise the entity's capital resources. IAS 1 paragraph 134 requires an entity to disclose information that enables its users to evaluate the entity's objectives, policies and processes for managing capital. These disclosures require both quantitative and qualitative information of what it manages as capital.

Specific areas

The determination of fair value of investment property or property, plant and equipment

The fair value of investment properties, and items of property, plant and equipment must reflect market participant views and market data at the measurement date under current market conditions. There may be an increase in the amount of subjectivity involved in fair value measurements, especially those based on unobservable inputs. Instances where the physical structure of shopping centres and warehouses were damaged would be inherent in the characteristic of the asset, due to its condition and location at the measurement date. Obsolescence encompasses physical deterioration, functional obsolescence and economic obsolescence and is generally taken into consideration from the perspective of the market participant buyer. The condition and location of the asset at the reporting date, regardless of the ability of the owner to restore its condition in the future should be taken into consideration in determining the fair value thereof. Instances where the shops of tenants were looted could potentially increase vacancy rates as well as assumptions about future cash flows of the assets and the inherent uncertainty regarding those cash flows. In some cases, greater use of unobservable inputs will be required because relevant observable inputs may no longer be available or relevant to unrest experienced. Observable inputs might require an adjustment that is significant to the entire fair value measurement, which could result in a fair value measurement categorised within level 3 of the fair value measurement.

Scrapping of assets

Assets for which no future economic benefits are expected from its use or disposal should be derecognised. When an entity has an insurance policy against the destruction of property or property damage, the potential insurance recovery should be evaluated and accounted for separately from the loss on derecognition. In instances of civil unrests, insurance claims could be complex and as such we recommend that the receivable for potential recoveries are only recognised once the entity has an established right to receive any insurance pay-out.

Insurance claims may require separate presentation in the Statement of Comprehensive Income in accordance with the requirements of IAS1 paragraph 84.

Government assistance and donations by NGO's

An entity that has historically not been eligible for government assistance may be entitled to receive government assistance to help restore industries and the economies of geographical areas. Donations by NGO's and other arms of government to assist businesses in affected areas would require careful consideration, specifically regarding the nature of these donations and assistance received. Management may need to establish an accounting policy regarding government assistance which needs to be appropriate and in line with the requirements in IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*. It is essential to distinguish between government assistance and government grants and ensure that grants are recognised only when the recognition criteria in IAS 20 is met. Some of the government assistance may involve deferral of tax payments or other tax allowances. The accounting treatment of tax allowances may need to be accounted for under IAS 12 *Income Taxes* rather than IAS 20. We refer to the guidance issued by SNG Grant Thornton which can be accessed here.

Specific areas

Revenue

Business disruption directly affects an entity's ability to generate revenue. The revenue of an entity may decline as a result of the looting and the economic impact thereof on the economy. If the entity's contract with the customer includes variable components (e.g., discounts), the entity must consider whether its previous estimates in this regard continue to be appropriate. IFRS 15 *Revenue from Contracts with Customers* provides extensive guidance around variable consideration and the related constraint. It may be necessary for an entity to begin constraining its variable revenue even if this was not considered necessary prior to unrests where, even though the economy was constrained as a result of the Pandemic, its own business and the businesses of its customers were not severely interrupted. The impact of business interruption has been discussed in detail in this guidance.

Inventory and supply chain disruptions

Some entities may be experiencing supply chain disruptions. Seasonal inventories and perishable products might be exposed to the risk of loss due to damage, contamination, physical deterioration and obsolescence. Entities would need to consider whether, at the reporting date, an adjustment is required to the carrying value of inventory to bring it to the net realisable value in accordance with the principles of IAS 2 *Inventories*. If an entity's production level is abnormally low, either as a result of the temporary shutdown of production in certain areas, the destruction of major production plants, or shifting of production to other plants in response to the looting, it may need to review its inventory costing to ensure that unallocated fixed overheads are recognised in profit or loss in the period in which they are incurred.

ECL of trade receivables

IFRS 9 *Financial Instruments* sets out a framework for determining expected credit losses ("ECLs") that should be recognised. ECL is based on information about past events, current conditions and forecasts of future economic conditions. In other words, even possible future outcomes that may or may not come to pass should be factored into an entity's ECLs on a probability-weighted basis. The negative economic outlook and cash flow difficulties experienced by customers as a result of unrest must be factored into an entity's forecasts of future conditions, which may result in an increase in its provision for ECLs. Entities should also consider the possibility of a higher magnitude of loss given default, due to possible decreases in the value or loss of collateral and other assets affected by looting or damage.

ECL applies to trade receivables, loans, debt securities, contract assets and assets arising from costs to obtain or fulfil a sales contract, as well as the losses recognised in measuring loan commitments and financial guarantee contracts. Regardless of whether the simplified approach or the 3-stage model set out in IFRS 9 is being applied to assess ECL, the impact of unrests on the ECL calculation needs to be very carefully assessed.

Even if estimates do not require revision, full disclosure of circumstances taken into consideration is recommended.

Other areas

Area of expected impact	Accounting Impact
Non-current Assets Held for Sale and Discontinued Operations	Some entities may decide to discontinue operations in affected areas. An entity may also be considering or implementing restructuring plans such as the sale or closure of part of its business or the downsizing of operations (either temporary or permanent) Management should consider whether any long-lived assets need to be classified as held for sale or if any portion of its business qualifies for presentation as a discontinued operation. Preparers of financial statements need to be mindful that IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* has specific conditions to be held for sale. Entities should perform an assessment of whether these operations meet the requirements in IFRS 5 to be held for sale, and present and disclose such operations as non-current assets held for sale and discontinued operations accordingly. Preparers are encouraged to disclose the judgements in respect of the classification clearly.
Financial guarantee contracts	An entity that has guaranteed an amount owing by another entity/individual should consider how the other entity/individual is impacted by the local unrests. Depending on the circumstances, the entity may need recognise an additional liability related to the guarantee which would be the higher of the ECL and the amount initially recognised, less amortisation.
Debt repayments and modification of terms	Entities affected by looting or damage may enter into negotiations with lenders and creditors to defer payments for a period of time as a result of cash flow constraints. Management will need to assess whether the change in terms represent a modification or extinguishment of the debt obligation. Furthermore, where repayment terms are deferred, preparers should reconsider the portion of the debt that is considered current versus non-current.
Breach of covenants	As a result of the difficult economic conditions worsened by the Pandemic and civil unrests, an entity that is normally able to comply with its debt covenants may find that it is now in violation of those covenants. This could result in loans becoming repayable on demand. Management should consider whether the classification of loans and other financing liabilities between non-current and current is affected and in extreme situations, whether the entity remains a going concern. Users should also consider the impact of cross default clauses being triggered on all other borrowings. We remind preparers of the disclosure requirements in IFRS 7 paragraphs 18 and 19.
Possible impairment of right of use asset ("ROUA")	Due to destruction caused on property leased, the lessee should consider whether the ROUA is impaired. This impairment assessment should be done in accordance with the requirements of IAS 36. If the lessee determined the ROUA to be classified as investment property, the fair value of the ROUA should be determined in accordance with IFRS 13.
Force majeure may apply	Very often lease contracts contain force majeure clauses. The application of force majeure should be considered on a case-by-case basis. Typically, where a force majeure clause forms part of the original lease contract entered into, the application of this clause would not result in a lease modification. The force majeure clause would rather lead to a remeasurement of the lease liability should the lease contract not terminate. On termination of lease contracts, the lease liability is derecognised.
Lease concessions	We remind users that the covid-19 practical expedient for lease concessions would not be applicable to lease concessions given as a result of damage, looting or the temporary closures to shopping centres and other to leased property or looting.
Exceptional items	An entity shall not present any item of income or expense as extraordinary items in the Statement of Comprehensive Income. Very often, when such items are presented as "extraordinary", the function of expense method and the nature of expense method in presenting profit or loss is unintentionally mixed.

Other areas

Area of expected impact	Accounting Impact
IAS 12 Income Taxes	We refer to the tax guide issued by SNG Grant Thornton which can be accessed on this link.
Capitalisation of borrowing costs	Some entities may suspend active developments of qualifying assets due to damages and losses caused by the unrest. An entity is required to suspend capitalisation of borrowing costs during extended periods in which active development of a qualifying asset is stopped. IAS 23 does not specify how long an 'extended period' of suspension of active development is. Entities may need to apply judgement to determine whether it should suspend capitalisation of borrowing costs. Entities should also consider the amounts that will be capitalised if they have renegotiated payments terms in light of depressed conditions.
Interim reports	Entities are required to disclose significant changes from the previous year (refer to IAS 34 paragraphs 15 – 16A), for example, in relation to: • Impairment of non-financial assets • Impairment of financial assets • Going concern uncertainties, and • Level 3 fair value measurements.
Impairment of goodwill	Goodwill is required to be tested annually for impairment. Civil unrest could impact goodwill through: • the testing for write-down or impairment of a significant asset group • the recognition of a goodwill impairment loss in an investee's separate financial statements or • a significant decline in the entity's share price which could result in the carrying amount of the entity's net assets exceeding its market capitalization. Significant changes with an adverse effect in the market, industry or operating environment is an indication that an asset may be impaired. We also remind users that changes in the market, industry or operating environment need not be permanent (refer to IAS 36 paragraphs BCZ95 – BCZ97) before an impairment loss is recognised. If the event that led to the decrease in the recoverable amount have already taken place (that is, if property was damaged at the reporting date), the carrying value of that asset should be reduced accordingly. Goodwill impairment losses can not be reversed in future periods.
Impairment of cash generating units	Financial forecasts developed using the entity's own data might have to be re-estimated depending on the severity of the impact of unrest on the financial performance of these cash generating units. Significant changes with an adverse effect on the entity in the market, economic or legal environment in which the entity operates, evidence of obsolescence or physical damage, plants becoming idle, or plans to discontinue or restructure the operation are indicators of impairment.
Restructuring costs	As a result of the difficult economic environment, escalated by unrests, an entity may be considering or implementing restructuring plans such as the sale or closure of part of its business or the downsizing of operations (either temporary or permanent). A provision for restructuring costs may only be recognised when the entity has a detailed plan for the restructuring and has raised a valid expectation in those affected by the restructuring.
Contingent liabilities and Contingent assets	Entities may anticipate losses on account of reduction in demand, supply chain disruptions or losses due to an overall decline in economic output. However, future operating losses on existing contracts do not meet the definition of a liability unless they fall in the category of onerous contracts, and hence, should not be provided for in accordance with IAS 37. Contingent liabilities and contingent assets are not recognised. An example of a contingent asset is a claim that an entity is pursuing through legal processes, where the outcome is uncertain.

Contact us

Should you have any queries, please do not hesitate to contact our Technical team.

Madelie Olivey
Director, Head of Technical Services

T +27 11 231 0600
E Madelie.Olivey@sng.gt.com

Omar Kadwa
Director, Technical

T +27 11 231 0600
E Omar.Kadwa@sng.gt.com

Head Office
20 Morris Street East
Woodmead, 2191
P.O. Box 2939
Saxonwold, 2132

For general enquiries please contact us at **info@sng.gt.com**

SNG Grant Thornton

sng-grantthornton.co.za