In the Spotlight

A Pharmaceutical & Life Science Industry Focus on COVID-19 Accounting Considerations

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COVID-19: Top 5 Accounting Issues for Pharmaceutical & Life Science entities

At a Glance
The coronavirus (COVID-19) pandemic has developed rapidly in 2020. Measures taken to contain the virus have affected economic activity, which in turn has implications for financial reporting.

Measures to prevent transmission of COVID-19 include limiting the movement of people, restricting flights and other travel, and temporarily closing businesses. Hospitals and health care professionals are focusing their efforts and resources on treating COVID-19 patients, resulting in some 'non- essential' treatments being deferred. Clinical trials might be stopped, or delayed, and active ingredients might be harder to ascertain.

COVID-19 will impact many areas of accounting and reporting for all industries, as outlined in our publication: In depth: Accounting Implications of the Effects of Coronavirus.

In this Spotlight we provide our insights into the top accounting issues that Pharmaceutical & Life Science ('PLS') entities might face. While this Spotlight focuses on issues that are likely to be the most frequently encountered, many others are certain to arise. As the situation continues to evolve, so too will the consequential accounting issues. For these reasons the following is not an exhaustive list of all relevant accounting considerations.

We believe that management should carefully consider the impact on each line item in the financial statements for both interim and annual reporting purposes. Several key issues that we expect to see impacting PLS entities are:

1. Asset impairment

IAS 36, 'Impairment of assets', requires goodwill and indefinite-lived intangible assets to be tested for impairment at a minimum every year, and other non-financial assets whenever there is an indicator that those assets might be impaired. PLS companies should assess whether the COVID-19 pandemic has led to an indicator of impairment. Some examples might be:

- A significant delay in the drug development cycle or approval process.
- A reduction in sales of new drugs due to sales representatives not being able to carry out in-person meetings with doctors, and those doctors reprioritising their time to treatment related to COVID-19.
- A reduction in sales of 'non-essential' or elective treatments and drugs due to reprioritisation.
- Laboratories and manufacturing sites closed due to lockdown provisions.
- Active Pharmaceutical Ingredients (API) supply disruption and increase in clinical trial costs.
- Significant or prolonged decrease in the entity's stock price.

An impairment test would be required where there is an indicator of impairment. Management should revise the assumptions and cash flow forecasts used to test for impairment, to reflect the potential impact of COVID-19.

2. Revenue & collectability

PLS entities are often required to provide products to both governments and private customers who might be impacted to varying degrees by the pandemic. Customers might lack the ability to pay, or pay on time – in particular, smaller distributors, hospitals and other institutions. A PLS entity might choose to continue to supply a customer even where it is aware that the customer might not be able to pay for some or all of the goods being supplied. Revenue is recognised where it is probable that the customer will pay the transaction price when it is due, net of any price concession. Slow payment does not, on its own, preclude revenue recognition.

Many countries have pricing regulation models in the PLS industry to control public spending in health care. Each scheme is different, but it often requires an amount to be paid back to the government. The amount of Pharma payback is unlikely to be known at the point when revenue is recognised, and so an estimate is made which reduces the transaction price. Historical assumptions that have been used to estimate government and private rebates and other revenue reductions might no longer be appropriate. PLS entities should reassess this estimate and only recognise revenue when it is highly probable that amounts recognised will not result in a significant reversal of cumulative revenue recognised when the uncertainty is resolved.

The amount of returns might increase. Many governments have required increased stock levels at hospitals and there has been panic buying of certain drugs. The estimate of expected returns should be calculated in the same way as other variable consideration. The transaction price should include amounts subject to return only if it is highly probable that there will not be a significant reversal of cumulative revenue if the estimate of expected returns changes.

3. Liquidity

In certain PLS entities, forecasted revenue, operating results and cash flow might decrease as a result of COVID-19 (for example, reduction of non-essential medical procedures, supply chain disruption, price concessions and overall decline in customer demand). In addition, the ability to access bank loans and capital markets is more limited as a result of the economic downturn, especially for smaller and start-up businesses.

Management should consider whether the liquidity situation causes substantial doubt about whether the entity will be able to continue as a going concern. The entity should also review arrangements with collaboration partners, to understand their going concern and liquidity positions and to assess whether this has any impacts on their own drug development pipelines and ability to do business.

4. Inventory

Inventory is measured at the lower of cost and net realisable value. A slowdown of the inventory cycle and decreased demand might make it necessary to write-down inventories to net realisable value. In certain PLS entities, inventory levels (including consignment inventory) might increase as a result of decreases in demand. ‘Non-essential’ drugs with a shorter shelf life might be required to be written off if they cannot be used in time. APIs and raw materials might be harder to access, due to lockdown and social distancing provisions further slowing down the supply chain. Supply chain and manufacturing costs might increase as a result of safety measures related to COVID-19. Supply chain disruptions could result in a corresponding reduction in sales and profitability

5. Disclosures

The impact of COVID-19 will likely require expanded and pervasive disclosures in footnotes. Disclosures might need to be updated more frequently as a result of the rapidly changing environment.

Management should consider the specific requirements in IAS 1 to disclose significant accounting policies, the most significant judgements made in applying those accounting policies, and the estimates that are most likely to result in an adjustment to profits in future periods. All of these disclosures might be different as a result of the impact of the virus. The extent of disclosures regarding estimation uncertainty might need to be increased, such as liquidity and going concern analysis, variable consideration assumptions, credit risk and expected credit loss calculation, and impairment.

Conclusion

COVID-19 has given rise to unprecedented challenges that have affected virtually every aspect of modern life. The economic implications of this coronavirus will have a consequent impact on many aspects of accounting and financial reporting. We hope that this Spotlight will help you and your advisors as you navigate the key issues.

Further information on the impacts of COVID-19 can be found in: In depth: Accounting Implications of the Effects of Coronavirus.