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TIME TO ADAPT

COVID-19 - Financial Reporting

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The FAQs below can help you better understand the potentially significant accounting and disclosure implications for your company, and the actions management can take now.

This resource centre will be continually updated as other significant accounting and reporting issues arise, so we encourage you to bookmark this page and check back frequently for updates.

1 **Going concern**: what are the relevant considerations?

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11 How should companies assess COVID-19 **events after the reporting date**?

New: new information added

References to 'Insights' mean our publication Insights into IFRS

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1- Going concern: what are the relevant considerations?

1-1 - Do events or conditions cast significant doubt on the company's ability to continue as a going concern?

What's the issue?

The impacts of the Covid-19 coronavirus outbreak have caused a significant deterioration in economic conditions for some companies and an increase in economic uncertainty for others. Management needs to assess whether these events or conditions, either individually or collectively ('current events or conditions'), cast significant doubt on the company's ability to continue as a going concern or, in severe cases, whether the going concern assumption is still appropriate as a basis for the preparation of the company's financial statements.

Although some sectors and jurisdictions may be more affected than others, all companies across all jurisdictions need to consider the potential implications for the going concern assessment.

It is clear that companies in highly exposed sectors that are experiencing declining demand, falling sales and margin pressures will be more significantly impacted – particularly travel and tourism, hospitality/entertainment/sport, retail and the oil industry. Over time, impacts on sectors such as automotive may increase, if consumers defer large purchases until the uncertainty recedes.

Current events and conditions may have a significant impact on a company's ability to continue as a going concern.

Getting into more detail

Going concern considerations, including financing challenges

Under IFRS® Standards, management is required to assess a company's ability to continue as a going concern. A company is no longer a going concern if management either intends to liquidate the entity or cease trading, or has no realistic alternative but to do so. [IAS 1.25]

Companies are required to disclose material uncertainties related to events or conditions that may cast significant doubt on their ability to continue as a going concern. In addition, disclosure is required when management concludes that there are no material uncertainties but reaching that conclusion involved significant judgement (a 'close call'). [Insights 1.2.80]

When management assesses the company's ability to continue as a going concern, it will need to consider the current economic uncertainty and market volatility caused by the Covid-19 outbreak, which has been further exacerbated by a decline in oil prices.

In assessing whether the going concern assumption is appropriate, management assesses all available information about the future (which is at least, but not limited to, 12 months from the reporting date), considering the possible outcomes of events and changes in conditions, and the realistically possible responses to such events and conditions that are available. [IAS 1.26]

Revising budgets and forecasts

In many cases, 2020 budgets and forecasts prepared in 2019 may now be of limited relevance given the rapidly changing economic and business circumstances. These may require significant revision – e.g. for forecast sales, gross margins and changes in working capital – to be able to support management's assessment in the current environment.

It is important that management's assessment considers different scenarios, including a reasonably plausible downside scenario. After updating the forecasts, management will need to assess whether it expects to remain in compliance with financial covenants.

It will be critical for management to assess what impacts the current events and conditions have on a company's operations and forecast cash flows, with the key issue being whether a company will have sufficient liquidity to continue to meet its obligations as they fall due.

For example, a company may need to consider whether:

- it has sufficient cash and unused credit lines/borrowing facilities to meet short-term needs;
- further actions are needed by management to enable the company to generate sufficient cash flows to meet its obligations when they fall due;
- it needs to negotiate with lenders to restructure and/or increase borrowing facilities;
- to restructure operations to reduce operating costs;
- to defer capital expenditure; or
- to seek financial support from shareholders and/or government programmes designed to support businesses.

Financing challenges

Management should reassess the availability of finance because it may not be easily replaced and the costs may be higher in the current circumstances.

- Borrowers with weaker credit ratings may find it more difficult to access bond markets, and may find banks and other lenders less willing to renew or increase borrowing facilities.
- Lenders may demand new terms, such as significantly higher yields or improved collateral, particularly for companies in highly exposed sectors.
- Lenders themselves may be experiencing liquidity issues and may need central bank assistance to be able to continue to provide, or increase, financing.
- Borrowers with foreign currency-denominated debt may find that debt servicing costs increase significantly due to the depreciation of their local currency.
- Covenants in loan agreements may provide lenders with an opportunity to withdraw financing.

If management concludes that the consequences of the outbreak will result in a deterioration in operating results and financial position after the reporting date that is so severe that the going concern assumption is no longer appropriate, then the financial statements would need to be adjusted – i.e. a change in the going concern assumption is considered an adjusting event. [IAS 10.14–15]

Disclosures

To the extent that events and conditions are identified that may cast significant doubt on a company's ability to continue as a going concern, disclosure of uncertainties is required if these events constitute material uncertainties or management's conclusion that there are no material uncertainties involved significant judgement. [Insights 1.2.80]

Supply chain, logistics and other disruptions or significant changes in demand can have implications for a company's working capital. Many companies would need to adjust the way they manage liquidity to respond to the current market turmoil, including the use of alternative sources of funding. Additional disclosures will be needed, explaining those changes and how the company manages its liquidity in these difficult economic conditions.

IFRS 7 *Financial Instruments: Disclosures* requires disclosure of quantitative data about liquidity risk arising from financial instruments. A company also needs to explain how it is managing this risk, including any changes from the previous period and any concentrations of liquidity risk. Disclosures addressing these requirements may need to be expanded, with added focus on the company's response to the impact of Covid-19. [IFRS 7.33]

Examples of specific disclosures required include:

- an explanation of how a company manages liquidity risk; and
- disclosures of defaults and breaches relating to the borrowings recognised during and at the end of the reporting period. [IFRS 7.18–19, 39(c)].

Given the significance and widespread impact of Covid-19, expanded disclosures may be necessary.

Actions for management to take now

When assessing a company's ability to continue as a going concern, management may need to do the following.

- Update forecasts and sensitivities, as considered appropriate, taking into account the risk factors identified and the different possible outcomes. It is important to consider downside scenarios – e.g. taking into account the impacts of a 'lockdown', when relevant.
- Review projected covenant compliance in different scenarios.
- Assess its plans to mitigate events or conditions that may cast significant doubt on the company's ability to continue as a going concern. In particular, management would be expected to reassess the availability of finance. The company needs to assess whether its plans are achievable and realistic.

2- Assets: are they being carried at appropriate amounts?

2-1 - Have non-financial assets become impaired – e.g. PPE, intangible assets and goodwill?

2-2 - Are fair values appropriately determined?

2-3 - Will taxable profits be available to recover deferred tax assets?

2-4 - Have lease assets become impaired?

2-5 - Are revenue-cycle assets recoverable?

2-6 - How might capitalisation of borrowing costs be affected? New

2-1 - Have non-financial assets become impaired – e.g. PPE, intangible assets and goodwill?

What's the issue?

Trigger for impairment testing

Many countries are implementing stringent measures to contain the spread of the Covid-19 coronavirus. These measures have significantly affected economic activity and sentiment, disrupting the business operations of companies worldwide – particularly those that:

- have been hit by a fall in demand for their products or services, or by restrictions imposed by the state;
- are dependent on supply chains or have production facilities in countries significantly affected by Covid-19; and/or
- trade with countries significantly affected by Covid-19.

The rapid deterioration in the economic environment and the increase in uncertainty in the macroeconomic and business outlook have triggered a sharp fall in stock markets worldwide accompanied by significant fluctuations in foreign exchange rates and commodity prices. As a result, the likelihood that a triggering event has occurred in the first quarter of 2020 and therefore that an impairment test is required has increased significantly, including for assets that are required to be tested for impairment annually.

Challenges in estimating cash flows

When a triggering event has occurred, management needs to determine the recoverable amount (the higher of VIU and FVLCD[1]) of an asset or cash-generating unit (CGU), which usually requires management to forecast future cash flows. Budgets and cash flow forecasts prepared by management generally serve as the starting point for the discounted cash flows used in calculating the recoverable amount. Significant assumptions, such as forecast sales volumes, prices, gross margins, changes in working capital, foreign exchange rates and discount rates will need to be reassessed and updated as appropriate due to the significant changes in economic and market conditions. Cash flows used in determining FVLCD should

be updated to reflect the assumptions that market participants would use based on market conditions and information available at the reporting date. [IAS 36.4, 9, 33, IFRS 13.2]

Making the estimate could be challenging given the degree of uncertainty about:

- the nature, severity and duration of measures taken to contain or delay the spread of Covid-19;
- how long it could take for business operations and economic activity to return to normal;
- the expected trajectory of the recovery (i.e. how quickly economic growth will resume) and the likelihood of a recession; and
- any lasting impact on the economy or the sector.

Reflecting risks in the discount rate

The discount rate used to discount the forecast cash flows under both VIU and FVLCD might be significantly affected by Covid-19 due to the increase in uncertainty and risks. The discount rate should reflect the impact of changes in interest rates and the risk environment at the reporting date. [IAS 36.56]

Disruptions to business operations and increased economic uncertainty due to Covid-19 may trigger the need to perform impairment testing in the first quarter of 2020. Estimating future cash flows to calculate the recoverable amount will be challenging given the high level of uncertainty.

Getting into more detail

Trigger for impairment testing

IAS 36 *Impairment of Assets* applies to a variety of non-financial assets including property, plant and equipment, right-of-use assets, intangible assets and goodwill, investment properties measured at cost and investments in associates and joint ventures[2]. [IAS 36.2, 4]

IAS 36 requires goodwill and indefinite-lived intangible assets to be tested for impairment at least annually and other non-financial assets when there is an indication of possible impairment (a triggering event). It provides examples of indicators of triggering events, including:

- when significant changes have taken place during the period (or will take place in the near future) in the market or in the economic environment in which the company operates and these changes will have an adverse effect on the company; and
- when the carrying amount of the company's net assets is higher than its market capitalisation. [IAS 36.9–10, 12]

The impacts of Covid-19 have caused a significant deterioration in economic conditions for many companies, and an increase in economic uncertainty for others, which may constitute triggering events.

- Certain sectors have been significantly impacted – e.g. travel, tourism, entertainment, retail, construction, manufacturing, insurance and education.
- Companies in extractive industries may also have been significantly affected by decreases in commodity prices and companies in countries that are economically dependent on these commodities may also be exposed to a greater risk of adverse economic impacts.
- Certain types of investment properties (and right-of-use assets arising from leased real estate) – e.g. retail and industrial properties – may be considerably affected by Covid-19. Tenants that have been forced to suspend operations may not be able to pay rent in the near term or may ask to renegotiate a lower rent. They may also become less creditworthy. Similar considerations would also apply for companies that lease assets (e.g. aircraft and shipping vessels) to the transport sector.

Challenges in estimating cash flows

Estimating future cash flows could be particularly challenging for many companies due to the increase in economic uncertainty.

- Under VIU, the cash flow projections should be based on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of the asset or CGU. Greater weight is given to external evidence. [IAS 36.33(a)]
- Under FVLCD, the estimates and assumptions used are from the perspective of market participants. [IFRS 13.22]

Due to the high degree of uncertainty and resulting challenges in forecasting cash flows, it could be helpful to base those forecasts on external sources such as economic projections by respected central banks and other international organisations.

To cushion the economic and financial market impacts, governments in certain regions and international organisations have committed to fiscal stimulus, liquidity provisions and financial support. Companies will need to understand the terms and status of these provisions and consider what impact they might have on their cash flow projections.

Reflecting risks in the discount rate

Covid-19 might have a significant impact on the risk-free rate and on entity-specific risk premiums (e.g. financing risk, country risk and forecasting risk) used in determining the appropriate discount rate to discount future cash flows. [IAS 36.A1, A16, A18]

The risk-free rate is generally based on the yield on government bonds that have the same or similar duration as the cash flows of the asset or CGU. In certain jurisdictions, the yield on long-term government bonds has decreased in the first quarter of 2020. However, a decrease in the risk-free rate following a decrease in the yield on government bonds may not translate into declines in a company's discount rate due to possible increases in credit and/or other risk premiums in the company's circumstances. [Insights 3.10.300.120]

For more information on the impact of Covid-19 on discount rates, see our web article on **fair value measurement**.

Considering the approach to projecting cash flows

Given the uncertain macroeconomic outlook, with scenarios ranging from economic disruption for a few months before economic activity returns to normal, through to a lengthy period of disruption triggering a significant recession, estimation uncertainty will be significantly higher than normal and there will probably be a wider range of reasonably possible cash flow projections.

Two approaches can be used to project cash flows:

- the traditional approach, which uses a single cash flow projection, or most likely cash flow; and
- the expected cash flow approach, which uses multiple, probability-weighted cash flow projections. [IAS 36.A4–A14]

Given the high degree of uncertainty, it may be helpful to consider using an expected cash flow approach as opposed to the traditional approach. Under the traditional approach, cash flows are not adjusted for risk but, rather, risk is reflected in determining the discount rate. Under the expected cash flow approach, the uncertainty about the future cash flows is reflected in the different probability-weighted cash flow projections used, rather than in the discount rate. The expected cash flow approach inherently requires a more explicit consideration of the wider than normal range of possible future outcomes. [IFRS 13.B26, IAS 36.A7, Insights 3.10.220]

Whichever approach a company adopts, the rate used to discount cash flows should not reflect adjustments for factors that have been incorporated into the estimated cash flows and vice versa. Otherwise, the effect of some factors will be double counted. [IAS 36.55–56]

Impact on useful life and residual value

If recent events have changed the company's usage or retention strategy for any of its property, plant and equipment, then management should review whether the useful life and residual value of these assets, and the depreciation method applied to them, remains appropriate. This review may also be required after testing a CGU or an asset for impairment. Any such changes are accounted for prospectively as a change in accounting estimate. [IAS 16.61, Insights 3.10.350.30]

Disclosure

Annual reports
In the context of impairment testing of goodwill and indefinite-lived intangible assets, IAS 36 requires disclosure of the key assumptions used to determine the recoverable amount. It also requires sensitivity disclosures if a reasonably possible change in a key assumption would cause the CGU's carrying amount to exceed its recoverable amount. Furthermore, IAS 1 *Presentation of Financial Statements* requires disclosure of the key assumptions that a company makes about the future and other major sources of estimation uncertainty at the reporting date that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities in the next financial year. [IAS 1.125, 129, 36.134(d)–(f)]

Because the uncertainty associated with management's assumptions about the future is likely to be significant, it is important that management develops robust disclosures to help users understand the degree of estimation uncertainty that exists in estimating the recoverable amount and the sensitivity of the recoverable amount to reasonably possible changes to key assumptions. For example, it may be appropriate to disclose management's views about the degree of uncertainty associated with the macroeconomic outlook (such as the severity and duration of the impact that Covid-19 is expected to have on the company's business) and/or the potential significance of disruption to the supply chain, factory shutdowns, fall in demand etc.

Interim condensed reports
IAS 34 *Interim Financial Reporting* requires disclosure of the nature and amount of changes in estimates. Impairment losses are examples of events and transactions that require disclosure under IAS 34 if they are significant. [IAS 34.15B(b), 16A(d)]

IAS 36 disclosures are not required in interim condensed financial statements. However, given the current economic uncertainties – and depending on the circumstances of the company – providing some or all of the disclosures required by IAS 36 may be helpful to users in understanding management's assessment of the economic outlook and how different scenarios could impact the recoverability of assets. [Insights 5.9.60.70]

Actions for management to take now

Consider whether there are any indicators of impairment for the company's CGUs or assets that are tested on a stand-alone basis. In particular, assess:

- the impact of measures taken to contain Covid-19 on the company's business; and
- whether net assets exceed market capitalisation.

Consider whether budgets and cash flow projections reflect the following to the extent applicable to the company, based on information available at the reporting date:

- projections of central banks and other international organisations about the duration and severity of the impact of Covid-19;
- supply of and demand for the CGU's products or services;
- the decline in economic activity;
- the impact of restrictions on transport, travel and quarantines;
- the impact of exchange rates and commodity prices; and
- the fiscal stimulus, liquidity provision and financial support from the state or international organisations.

Consider whether discount rates used in recent valuations have been updated to reflect the risk environment at the reporting date.

Consider enhancing sensitivity disclosures and disclosures about the key assumptions and major sources of estimation uncertainty in the interim and annual reports.

[1] VIU: value in use; FVLCD: fair value less costs of disposal.

[2] The guidance in IAS 28 *Investments in Associates and Joint Ventures* is used to determine whether it is necessary to perform an impairment test for investments in equity-accounted investees. If there is an indication of impairment, then the impairment test follows the principles of IAS 36. [IAS 28.40-42]

2-2 - Are fair values appropriately determined?

What's the issue?

The COVID-19 coronavirus pandemic has significantly affected financial markets in the first quarter of 2020. Stock markets have declined sharply and volatility has increased. Treasury bond yields have reached record lows and credit-default-swap indices have been surging, reflecting concerns of increased corporate defaults. For many assets and liabilities, fair values may have changed significantly, reflecting changes in cash flow forecasts, higher uncertainty and elevated risks.

Fair value is a market-based measurement – it is measured using assumptions that market participants would use, reflecting market conditions at the measurement date. According to IFRS 13 *Fair Value Measurement,* a quoted price in an active market provides the most reliable evidence of fair value and if one is available then it has to be used to measure fair value. Use of hindsight or adjusting for what may be viewed as depressed pricing at the measurement date in light of subsequent changes in market prices is not permitted. [IFRS 13.77, 79]

Performing a valuation that uses significant unobservable inputs is challenging, especially at times, as now, when markets are volatile and the economic outlook is highly uncertain and may change quickly.

The fair value of an asset (or liability) should reflect market conditions at the measurement date. This has become more challenging due to the uncertainty of the economic impact of COVID-19.

Getting into more detail

'Unobservable inputs' are inputs for which market data is not available and that are developed using the best information available about the assumptions that market participants would make in pricing the asset or liability, including assumptions about risk. Unobservable inputs used in valuations may require significant adjustment to reflect the risks and uncertain market conditions at the measurement date. [IFRS 13.A]

Reflecting risks and market conditions at the measurement date

Some of the key factors and risks to consider when measuring fair value using a valuation technique include the following.

- **Economic activity levels.** Measures taken to contain the virus may lead to a significant reduction in economic activity in terms of production of and demand for goods and services, and may have a negative impact on forecast future cash flows used in a discounted cash flow valuation method.
- **Credit risk and liquidity risk**. The uncertain economic environment has resulted in increases in credit risk and liquidity risk for many companies. Own credit risk and/or counterparty credit risk used as inputs into valuation techniques may therefore increase.
- **Forecasting risk.** Fair value measurements should reflect the greater uncertainty in making economic and financial forecasts in the near term, due to the difficulty in forecasting the magnitude and duration of the economic impact of COVID-19.

- **Foreign exchange risk.** Companies with significant sales or purchases in foreign currencies may be adversely affected by exchange rate movements.
- **Commodity price risk.** Companies in extractive industries may be significantly affected by decreases in commodity prices. Companies in countries that are economically dependent on these commodities may also have greater risk of adverse economic impacts.

Significant judgment may be needed to quantify risk premiums and other adjustments for these risks. Also, the number of fair value measurements classified as Level 3 in the fair value hierarchy may increase (e.g. due to unobservable inputs such as the credit risk becoming significant in the current environment).

What do you need to disclose?

Annual reports
Given the impact of the increase in economic uncertainty on forecasting cash flows and other unobservable inputs used in valuation techniques (e.g. certain risk-adjusted discount rates), companies may need to provide sensitivity disclosures – together with disclosure of the key assumptions and judgements made by management – to enable users to understand how fair value has been determined. These disclosures are required under both IFRS 13 *Fair Value Measurement* and IAS 1 *Presentation of Financial Statements.* IFRS 13 also contains specific disclosure requirements when amounts are transferred into Level 3 of the fair value hierarchy, including sensitivity disclosures. [IFRS 13.93(e)(iv), 93(h), IAS 1.125, 129]

Interim reports
IAS 34 *Interim Financial Reporting* requires companies to provide many of the IFRS 13 disclosures on fair value measurement of financial instruments, including the sensitivity disclosures and significant transfers between levels in the fair value hierarchy. Additionally, IAS 34 requires companies to explain events and transactions that are significant to an understanding of the changes in a company's financial position and performance since the last annual reporting date. Therefore, fair value disclosures related to non-financial assets and non-financial liabilities are required if they are material to an understanding of the current interim period. This may be the case when fair values change significantly. [IAS 34.15, 16A(j)]

Actions for management to take now

- Consider whether the valuation:
  - reflects market participants' assumptions based on information available and market conditions at the measurement date; and
  - incorporates the risk premiums that would arise from the increased uncertainty and other impacts of COVID-19.
- Consider whether unobservable inputs have become significant, which would result in a Level 3 categorisation and require additional disclosures.
- Consider expanding disclosures about the key assumptions, sensitivities and major sources of estimation uncertainty.

2-3 - Will taxable profits be available to recover deferred tax assets?

What's the issue?

As the COVID-19 coronavirus continues to spread around the world, many companies face unprecedented challenges, which may adversely impact their operations. To help them, many governments are introducing specific measures. Both the current challenges and the government's measures may affect a company's projections of future taxable profits.

Companies need to consider the effect of any changes to the projections and probability of future taxable profits on the recognition of deferred tax assets under IFRS® Standards.

COVID-19 may impact projections of future taxable profits that are used to assess the recoverability of deferred tax assets.

Getting into more detail

Under IAS 12 *Income Taxes,* a deferred tax asset is recognised for deductible temporary differences and unused tax losses (tax credits) carried forward, to the extent that it is probable that future taxable profits will be available. [IAS 12.24, 34]

The amount of future taxable profits to be used when assessing the recoverability of a deferred tax asset is not the bottom line of a company's tax return. To determine whether future taxable profits will be available, a company first considers the availability of qualifying taxable temporary differences, and then the probability of other future taxable profits and tax planning opportunities. In other words, if a company is loss-making, it can still recognise a deferred tax asset if it has sufficient qualifying taxable temporary differences to meet the recognition test. [IAS 12.28–29, IU 05-14]

In the current circumstances, a company's projections of future taxable profits may be affected by:

- changes in forecast cash flows – e.g. expected decrease in production or sales prices vs increase in costs;
- changes in a company's tax strategies;
- substantively enacted changes to the income tax law introduced as part of a government's measures in response to COVID-19 – e.g. tax reliefs for certain types of income, additional tax deductions, a reduced tax rate or an extended period to use tax losses carried forward; and
- changes in a company's plans to repatriate or distribute profits of a subsidiary that may result in the recognition of a deferred tax liability (i.e. additional taxable temporary differences).

Some of these changes may reduce future taxable profits, while others may potentially increase them. In addition, some of the changes – e.g. government's measures in response to COVID-19 – may impact the timing of the reversal of temporary differences.

When preparing projections of future taxable profits for the purposes of the deferred tax asset recognition test, a company needs to reflect expectations at the reporting date and use assumptions that are consistent with those used for other recoverability assessments – e.g. **impairment of non-financial assets.**

If the recognition threshold is met, then the company recognises a deferred tax asset and measures it using the tax rate expected to apply when the underlying asset is recovered based on rates that are enacted or substantively enacted at the reporting date (similar to deferred tax liabilities and current tax). [IAS 12.47, 51]

Actions for management to take now

- Monitor government actions and consider whether any income tax relief is available.
- Determine whether there is a substantively enacted change in the income tax law; if there is, then it may impact the recognition and measurement of deferred tax assets.
- Establish whether there is an intention to repatriate or distribute a subsidiary's profits, because this would trigger recognition of a deferred tax liability.
- Consider how the current economic conditions could affect the company's tax strategies and plans.
- Consider whether there is any uncertainty about income tax treatments.
- Update projections for the reversal of taxable temporary differences and for other future taxable profits, ensuring that the assumptions are consistent with those used for other recoverability assessments.
- Provide clear and transparent disclosure about judgements and estimates made in recognising and measuring deferred tax assets.

2-4 - Have lease assets become impaired?

What's the issue?

Many of the companies that have been hardest hit by the impact of the COVID-19 coronavirus outbreak commonly lease the core assets they use in their business. This includes retailers that lease stores, and transport companies that lease aircraft, ships and rolling stock.

The right-of-use assets arising under these lease contracts are now subject to impairment testing under IAS 36 *Impairment of Assets.* This is a significant change from the onerous lease test that companies applied before implementing IFRS 16 *Leases.*

Although impairment testing of right-of-use assets is generally similar to impairment testing of **other non-financial assets**, additional considerations apply.

Lessors generally apply IFRS 9 *Financial Instruments* to test lease receivables for impairment.

Companies may face challenges in determining the impairment charge for lease assets given the uncertainties involved and the additional considerations that apply when testing lease assets for impairment.

Getting into more detail

Impairment considerations for lessees

The principles and procedures of IAS 36 that apply to impairment of other non-financial assets apply equally to right-of-use assets. For example, right-of-use assets are allocated to cash-generating units (CGUs) and an impairment test is performed when, and only when, it is required by IAS 36. However, additional considerations apply.

Leases to which the lessee applies the right-of-use model

Generally, a right-of-use asset is tested for impairment as part of the larger CGU to which it relates. However, a right-of-use asset that meets the definition of investment property and is measured at cost is tested for impairment separately because it generates independent cash flows. [Insights 3.10.670]

Right-of-use assets that meet the definition of investment property and are measured at fair value are excluded from the scope of IAS 36.

The related lease liability is also included in the carrying amount of the CGU if, on disposal of the CGU, a potential buyer would be required to assume the lease liability. Companies need to make this assessment, which also affects the CGU's recoverable amount.

If the buyer *would be required* to assume the lease liability, then:

- if the recoverable amount of the CGU is determined using value in use (VIU), then the company deducts the carrying amount of the lease liability both from the CGU's carrying amount and from its VIU; and
- if the recoverable amount of the CGU is determined using fair value less costs of disposal (FVLCD), then the company deducts the carrying amount of the lease liability only from the CGU's carrying amount; the lease liability is inherently reflected in the CGU's FVLCD. [Insights 3.10.670.30]

If the buyer would not be required to assume the lease liability, then the company excludes the lease liability from the carrying amount of the CGU and, to achieve a like-for-like comparison, excludes the lease payments from the discounted cash flows used to measure the CGU's VIU. Similarly, the CGU's FVLCD excludes the lease liability.

Leases to which the lessee applies the recognition exemptions

Under IFRS 16, a lessee can choose not to apply the right-of-use model to some leases – i.e. short-term leases and leases in which the underlying asset is of low value. For these leases, the lessee includes the future lease payments in the cash flow forecasts when calculating the CGU's recoverable amount. [IFRS 16.5]

Impairment considerations for lessors

For operating leases, a lessor includes the underlying leased asset in the carrying amount of the CGU and applies IAS 36. The lessor includes the future cash receipts in its cash flow forecasts. In addition, the company applies IFRS 9 to test operating lease receivables for impairment.

To test finance lease receivables for impairment, a lessor generally applies IFRS 9, and also applies IFRS 16 to recognise reductions in the unguaranteed residual value of the underlying asset. [Insights 7.8.410]

Can a lease ever be onerous?

Generally, a lessee does not apply IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to leases.

However, in the following specific circumstances, companies may be required to recognise a provision under IAS 37 for their lease contracts:

- for leases to which the company applies one of the recognition exemptions, if those leases become onerous;
- for the non-lease components in a lease contract – e.g. maintenance obligations – if those components become onerous; and
- for a lease that becomes onerous after inception but before commencement date – i.e. after the company is contractually committed to the lease but before it recognises the assets and liabilities arising from the lease. [IAS 37.5(c)]

Disclosure

IAS 36 requires disclosure of the key assumptions used to determine the recoverable amount of the CGU. It also requires sensitivity disclosures if a reasonably possible change in a key assumption would cause the CGU's carrying amount to exceed its recoverable amount.

Furthermore, IAS 1 *Presentation of Financial Statements* requires disclosure of the key assumptions that a company makes about the future and other major sources of estimation uncertainty at the reporting date that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities in the next financial year. [IAS 1.125, 129, 36.134(d)–(f)]

Actions for management to take now

- Assess whether there are any indicators of impairment for the CGUs to which the right-of-use asset relates.
- Assess whether IAS 36's requirements have been applied appropriately when testing if the right-of-use asset has been impaired.
- Assess whether any onerous contract provisions need to be recognised.
- Consider enhancing sensitivity disclosures and disclosures about the key assumptions and major sources of estimation uncertainty.

2-5 - Are revenue-cycle assets recoverable?

What's the issue?

The COVID-19 coronavirus outbreak has had adverse effects on many companies' operations and their revenue cycles. Demand from customers may be down and customers may struggle to pay amounts owed when they become due. Companies may also be experiencing challenges in delivering goods and services to customers – e.g. due to disruption in their supply chains or imposed restrictions.

Companies need to assess whether assets related to the revenue cycle are appropriately measured to reflect these factors at the reporting date. For example, companies may need to consider the following.

- Are receivables and contract assets impaired?
- Do inventories need to be written down to net realisable value?
- Are capitalised contract costs recoverable?

These estimates may require significant judgement given the unprecedented level of uncertainty.

Assets related to the revenue cycle – e.g. receivables, contract assets, inventories and capitalised contract costs – may need to be written down as a result of the COVID-19 outbreak.

Getting into more detail

As part of the revenue cycle, companies may recognise receivables, contract assets, inventories and capitalised contract costs. Under IFRS® Standards, different requirements apply to the subsequent measurement of these assets.

Receivables and contract assets

Customers may struggle to pay amounts due under revenue contracts. Companies need to assess both receivables and contract assets for **impairment** under IFRS 9 *Financial Instruments* – i.e. using an expected credit loss model. Companies present any impairment losses separately from revenue from contracts with customers, and disclose them separately from impairment losses from other contracts. [IFRS 15.107–108, 113]

Companies also need to consider carefully whether new and existing contracts meet the **existence criteria** in IFRS 15 *Revenue from Contracts with Customers.* This may impact their assessment of whether to recognise revenue and related receivables or contract assets.

Inventories

Inventories are measured at the lower of cost and net realisable value under IAS 2 *Inventories.* Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and sale. [IAS 2.6]

The COVID-19 outbreak may affect the estimated net realisable value in several ways.

- Estimated selling prices may fluctuate due to changes in customer demand.
- Estimated costs to complete may change due to increases in the cost of materials or labour.

Companies need to estimate net realisable value based on the most reliable evidence at the time the estimate is made. Companies consider the effect of events occurring after the end of the reporting period to the extent that they confirm conditions existing at the reporting date. These estimates may require significant judgement, particularly when inventories will not be realised for a long period of time. [IAS 2.30]

Companies disclose the amount of any write-down of inventories recognised as an expense in the period. [IAS 2.36]

Capitalised contract costs

Costs to obtain and costs to fulfil a contract are capitalised under IFRS 15 only if they are expected to be recovered. Companies need to consider carefully whether new costs should be capitalised in the current environment and whether costs that have been capitalised are still recoverable. [IFRS 15.91, 95]

Amortisation period

A company amortises capitalised contract costs on a systematic basis consistent with the pattern of transfer of the good or service to which the asset relates. This includes goods and services under an existing contract as well as specific anticipated contracts – e.g. optional renewal periods. [IFRS 15.99]

Companies need to consider carefully whether the COVID-19 outbreak has affected the expected timing of transfer of the goods or services to the customer. For example, are there changes in expected customer renewals or the expected timing for completion of a long-term project? A company accounts for a change in the amortisation period as a change in accounting estimate under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* – i.e. on a prospective basis. [IFRS 15.100]

Impairment

Companies assess capitalised contract costs under the specific impairment requirements of IFRS 15. An impairment loss is recognised to the extent that the carrying amount exceeds the recoverable amount, which is the:

- remaining expected amount of consideration to be received in exchange for the goods or services to which the asset relates; less

- costs that relate directly to providing those goods or services and that have not been recognised as expenses.

When assessing for impairment, the expected consideration includes 'unconstrained' estimates of variable consideration and the effects of the customer's credit risk. [IFRS 15.101–102]

The COVID-19 outbreak may impact the amount of consideration that a company expects to receive – e.g. because of changes in **estimates** of variable consideration, increases in customer credit risk or revised expectations about whether customers will renew contracts or purchase additional goods. Companies should also update their estimates of the expected costs to provide goods or services in the current environment.

Companies disclose the amount of amortisation and any impairment losses recognised in the reporting period. [IFRS 15.128]

Actions for management to take now

- Assess both contract assets and receivables for impairment under IFRS 9.
- Ensure that estimates of net realisable value for inventory reflect the latest expectations of selling prices and projected costs to complete.
- Consider whether the amortisation period for capitalised contract costs needs to be updated.
- Assess capitalised contract costs for impairment under the requirements in IFRS 15, considering changes in the expected amount of consideration and projected costs to provide goods or services.
- Provide clear and meaningful disclosures about judgements and estimates made in measuring revenue-related assets.

2-6 - How might capitalisation of borrowing costs be affected? New

What's the issue?

Under IAS 23 *Borrowing Costs*, a company capitalises borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset – i.e. one that necessarily takes a substantial period of time to get ready for its intended use or sale. [IAS 23.1, 5]

If a company suspends active development of a qualifying asset for an extended period, then it also suspends capitalisation of the borrowing costs for that asset. [IAS 23.20]

The economic turbulence resulting from the COVID-19 coronavirus pandemic might lead to the suspension of projects due to legal restrictions on working or shortages of labour or supplies.

Borrowing costs eligible for capitalisation reflect the interest expense calculated under the effective interest method. Therefore, the renegotiation or modification of borrowing terms may affect the amount of eligible borrowing costs. [IAS 23.6]

Interruptions in construction and development projects due to the COVID-19 outbreak could lead to a suspension in the capitalisation of borrowing costs.

Getting into more detail

Suspension of projects

The standard does not specify how long an 'extended period' of suspension of active development is. However, a company does not normally suspend capitalisation during a period when it carries out *substantial* – as opposed to insignificant – technical and administrative work. Similarly, it does not suspend capitalisation when a temporary delay is a necessary part of the development process – e.g. for an external but common event or an interruption that is a typical part of the process. Therefore, a company may need to apply judgement to determine whether it should suspend capitalisation of borrowing costs. [IAS 23.21, Insights 4.6.160.30]

Government actions to fight the COVID-19 outbreak might cause many physical development projects to pause – e.g. because project workers need to stay at home. A company needs to consider both the expected length and the nature of the suspension when evaluating whether an interruption caused by the COVID-19 outbreak will continue for an extended period.

A company continues to capitalise borrowing costs if:

- the interruption is for only a short duration;
- it continues to perform substantial administrative or technical work; or
- it can demonstrate that the interruption is due to a common external event or is a typical part of the process.

Renegotiation of borrowings

Eligible borrowing costs for projects that have not been suspended for an extended period include interest expenses calculated using the effective interest method under IFRS 9 *Financial Instruments*. This includes the actual cost of borrowings taken out for specific qualifying assets and the weighted-average rate on general borrowings used to fund qualifying assets. Therefore, modifications to financial liabilities that are agreed with lenders may lead to adjustments to interest expense that affect the amount of eligible borrowing costs to be capitalised. [IAS 23.6]

Actions for management to take now

Reassess whether long-term development projects on which borrowing costs are capitalised are being suspended for an extended period because of the COVID-19 outbreak.

If borrowing costs continue to be capitalised, then consider whether the amounts to be capitalised should change as a result of modifications to the contractual terms of those borrowings.

3- Liabilities: are all liabilities fully recorded and properly presented?

3-1- Has Covid-19 resulted in an unavoidable liability or a loss-making contract?

3-2 - When is the right time to recognise a restructuring provision?

3-3 - How does COVID-19 impact current and non-current classification of debt?

3-1- Has Covid-19 resulted in an unavoidable liability or a loss-making contract?

What's the issue?

The Covid-19 coronavirus outbreak has impacted many companies adversely – e.g. affecting their production processes, disrupting their supply chains, causing labour shortages and leading to closures of stores and facilities.

This means that some existing purchase or sale contracts may become loss-making and require a provision. In addition, some companies may struggle to fulfil legal or contractual obligations and may be subject to penalties – e.g. for delays or non-performance – also resulting in a provision.

However, a provision is recognised only for an existing present obligation – not for future operating losses.

If Covid-19 results in a liability, or a contract becoming loss making, then the company needs to recognise a provision.

Getting into more detail

Onerous contracts

IFRS® Standards provide specific guidance for onerous (loss making) contracts – i.e. those in which the unavoidable costs of meeting the obligations exceed the economic benefits expected to be received under the contract. The unavoidable costs are the lower of the net costs of fulfilling the contract and the cost of terminating it.

A sales contract may become onerous if costs rise or are expected to rise – e.g. because the company needs to stop production, find an alternative supplier or hire additional employees. A sales contract may also become onerous if benefits are expected to be lower – e.g. because a fall in demand affects the pricing. When assessing the unavoidable costs, companies should consider the contract terms carefully, including termination and force majeure clauses.

When preparing projections of costs and benefits for the onerous contract test, a company needs to reflect expectations at the reporting date and use assumptions that are consistent with those used for other recoverability assessments – e.g. **impairment of non-financial assets**. As the situation surrounding Covid-19 is rapidly changing, a company may need to update projections it made before the reporting date to reflect the information available, conditions and outlook at the reporting date.

The provision for an onerous contract is discounted if the effect of the time value of money is material. Central banks in many countries are cutting interest rates in response to increasing concerns about the economic impact of Covid-19; this in turn may impact risk-free rates, which are often used to discount provisions. Companies need to update the discount rate if it has changed.

Before recognising a provision for an onerous contract, a company tests all assets dedicated to the contract for **impairment.**

Penalties

Under IFRS Standards, if a company has a present obligation, which cannot be avoided and is expected to result in the outflow of economic resources, then it recognises a provision if the amount can be estimated reliably.

Companies need to review their existing contracts and consider the interpretation of applicable law, particularly force majeure clauses, to determine whether they have an obligation triggered by Covid-19. In some cases, this may require them to recognise additional provisions – e.g. for failure to comply with applicable laws and regulations. Conversely, in some countries the outbreak may be regarded as force majeure and penalties for non-performance, late delivery or cancellation may be waived. This assessment may require legal advisors to be involved.

Future operating losses

A provision is recognised only for an existing present obligation – i.e. a company cannot recognise a provision for future operating losses or business recovery costs.

Actions for management to take now

- Consider if Covid-19 has triggered a liability that would result in an outflow of resources.
- Review termination clauses in key purchase and sales contracts to determine whether the cost of exiting a contract is lower than the cost of fulfilling it. Consider if Covid-19 falls under the force majeure clause in your jurisdiction.
- Update projections of costs and benefits for the onerous contracts test. Ensure that the assumptions are consistent with projections made for other purposes – e.g. impairment analysis. Check whether the risk-free rate used to discount provisions has changed.
- Perform the impairment test first before recognising a provision for an onerous contract.

- Provide clear and meaningful disclosures about judgements and estimates made in recognising and measuring provisions.

3-2 - When is the right time to recognise a restructuring provision?

What's the issue?

As the COVID-19 coronavirus continues to spread around the world, many companies need to adjust their operations and some may plan longer-term changes. Management may consider downsizing or discontinuing specific operations; conversely, some companies may plan to explore a new business opportunity. All of these may lead to a restructuring.

Management's plans alone do not necessarily result in a restructuring provision in the financial statements. A restructuring provision is recognised only when specific conditions are met, and only for qualifying costs.

If an entity plans restructuring to respond to COVID-19, then it recognises a restructuring provision only when specific conditions are met.

Getting into more detail

IFRS® Standards provide specific guidance on when to recognise a restructuring provision and at what amount. A 'restructuring' is a programme planned and controlled by management that materially changes the scope of the business or the manner in which it is conducted. [IAS 37.10]

Recognition

Under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, a restructuring provision is recognised only when both of the following conditions are met:

- there is a detailed formal plan for the restructuring; and
- a company has raised a valid expectation in those affected that the plan will be implemented – i.e. either by starting to implement the plan or announcing its main features to those affected. [IAS 37.72]

For example, suppose a company decides to close down one of its production facilities as a result of COVID-19. If the company announces its plan, specifying the facility to be closed, the estimated timing of the closure and the approximate number of employees it plans to make redundant, then it recognises a restructuring provision. The approval of the restructuring plan by the company's board is not by itself sufficient to recognise a restructuring provision. [IAS 37.75]

Termination benefits for employees made redundant as part of the restructuring are recognised in accordance with the specific requirements of IAS 19 *Employee Benefits.*

Measurement

Under IAS 37, restructuring provisions include only direct costs arising from the restructuring – e.g. employee termination benefits and consulting fees that relate directly to the restructuring, **onerous contract provisions**, contract termination costs and expected costs from when operations cease until final disposal. [IAS 37.80]

Costs associated with ongoing activities are not included in restructuring provisions. For example, the costs of retaining or relocating employees, administration or marketing costs and investment in new systems are not recognised as part of a restructuring provision. [IAS 37.81]

Actions for management to take now

- Monitor government actions and consider all available government assistance when determining the need for restructuring.
- Assess whether the plan (or need for a plan) to restructure triggers impairment of assets and perform the **impairment test** if necessary.
- Ensure that a formal detailed restructuring plan is in place, and that those affected by the plan have a valid expectation that it will be carried out, before recognising a restructuring provision.
- Ensure that the restructuring provision does not include costs associated with the company's ongoing activities, unless they relate to an onerous contract.
- Provide clear and transparent disclosures about the nature of the restructuring provision, the expected timing of any resulting outflows of economic benefits and related uncertainties. [IAS 1.98(b), 125, 37.85(a)–(b)]

3-3 - How does COVID-19 impact current and non-current classification of debt?

What's the issue?

A significant deterioration in companies' operating results and financial positions as a consequence of the COVID-19 coronavirus outbreak may cause breaches of debt covenants or trigger subjective covenant clauses. These could render the related debt repayable on demand before the contractual maturity date, leading to current rather than non-current classification at the reporting date.

When loan agreements include subjective covenant clauses – e.g. 'material adverse change' clauses – companies will need to exercise judgement in determining whether those subjective clauses are breached.

Even if a breach has not occurred by the reporting date, companies will need to assess their ability to maintain compliance with debt covenants, in order to decide whether to renegotiate the covenant clauses with lenders.

The current conditions arising from the COVID-19 outbreak may trigger breaches of debt covenants or material adverse change clauses. Such breaches could cause debt to be classified as a current liability – i.e. if it becomes repayable on demand.

Getting into more detail

How debt covenants affect the classification of debt

Under IFRS® Standards, when a company breaches a provision of a long-term loan arrangement on or before the reporting date such that the liability becomes repayable on demand, it classifies the liability as current. This is because the company does not have an unconditional right to defer its settlement for at least 12 months after that date. [IAS 1.74, Insights 3.1.40.90]

However, if by the reporting date the company obtains from the lender an agreement to provide a grace period ending at least 12 months after the reporting date, then the liability is classified as non-current. [IAS 1.75]

If the company obtains this agreement after the reporting date, then this is treated as a non-adjusting event. This means that the company is required to classify the liability, which is now repayable on demand as a result of the breach, as current at the reporting date. [IAS 1.76]

Greater challenges in complying with debt covenants

In the current economic environment, it is likely that companies will find it more difficult to comply with debt covenants. The following circumstances, for example, either individually or collectively, could cause a significant deterioration of financial performance and financial ratios, which may in turn lead to a breach of debt covenants:

- a decrease in customer demand;
- a disruption in production or supply;
- an impairment loss caused by doubts about the recoverability of financial or **non-financial** assets that lead to impairment losses;
- a decrease in the **market price of investments** held; or
- an increase in the provision for certain obligations – e.g. those arising from **onerous contracts** or **restructuring plans**.

If a breach of covenant results in the debt becoming repayable before the contractual maturity date, then management would need to consider the breach as part of a broader assessment in determining the company's ability to continue as a **going concern**.

When a company breaches a debt covenant relating to borrowings recognised during and at the end of the reporting period, IFRS 7 *Financial Instruments: Disclosures* requires specific disclosures in the financial statements. [IFRS 7.18–19]

Evaluation of subjective covenant clauses

Some loan agreements may include covenant clauses that are not based on financial ratios, making the determination of whether a breach occurs more subjective. Some clauses could trigger an acceleration of repayment if, for example, the company's share price falls or the value of assets provided as collateral decreases. Other clauses may be less definitive – e.g. a loan agreement may give the lender the right to demand immediate repayment when the borrower experiences 'significant financial difficulties'. However, this term may not be clearly defined in the loan agreement and companies will need to exercise judgement to determine whether a breach occurs on or before the reporting date.

Subsequent events

Any refinancings, amendments or waivers that are agreed after the reporting date are not considered in determining the classification of debt, but are disclosed as non-adjusting events. [Insights 2.9.40.10]

Interim reporting considerations

Companies should consider the classification of assets and liabilities as current or non-current at the interim reporting date. For example, debt for which provisions are breached at the interim reporting date such that the liability becomes repayable on demand would need to be classified as current, unless the company obtained a waiver before the interim reporting date.

Actions for management to take now

To assess whether debt subject to covenant clauses needs to be classified as current or non-current at the reporting date, management may need to do the following.

- Review covenant clauses in loan agreements and assess whether a breach has occurred or is likely to occur at the reporting date.
- Assess whether it is necessary to obtain a waiver or grace period from the lender if a breach has occurred.
- Evaluate the company's ability to maintain compliance with debt covenants and consider whether a renegotiation of covenant clauses with lenders is necessary.
- Provide the disclosures required under IFRS Standards.

4- Financial instruments: what are the key impacts?

4-1 - How have economic forecasts used to measure expected credit losses been updated?

4-2 - How has the credit risk of borrowers and other debtors been reassessed?

4-3 - Are fair values appropriately determined?

4-4 - How is hedge accounting impacted?

4-5 - Does a contract still meet the own use exemption?

4-6 - Have borrowers considered changes to the terms of their liabilities?

4-7 - How are expected credit losses on trade receivables impacted? New

4-1- How have economic forecasts used to measure expected credit losses been updated?

What's the issue?

Measurement of ECLs

IFRS 9 *Financial instruments* requires expected credit losses (ECLs) to be measured as an unbiased, probability-weighted amount, using reasonable and supportable information that is available without undue cost or effort at the reporting date. This includes information about past events, current conditions and forecasts of future economic conditions. [IFRS 9.5.5.17]

Evaluating ECLs requires companies to consider a range of possible outcomes and their respective probabilities, and to apply judgement when determining what constitutes reasonable and supportable forward-looking information.

Companies may find this particularly difficult for emerging issues:

- that have not previously been included in a company's planning and forecasting process; and
- whose future economic consequences are particularly challenging to determine.

However, a company cannot assert that reasonable and supportable information about a matter is unavailable simply because modelling its effects appears difficult or because it would involve a wider than usual range of possible results. [Insights 7.8.238]

The challenge for companies is to incorporate into their measurement of ECLs the forward-looking information relating to the economic impact of Covid-19 that is available without undue cost or effort at the reporting date.

ECL measurements need to incorporate forward-looking information that is available without undue cost or effort at the reporting date. This may be particularly challenging to do for the economic impact of Covid-19.

Getting into more detail

The Covid-19 coronavirus outbreak is already having severe economic impacts across many jurisdictions compared with 31 December 2019. The economic shocks may become more severe and spread to other jurisdictions. Many governments, central banks and economists have been revising their economic forecasts to try to capture the likely impacts. However, the economic outlook is highly uncertain and may change quickly.

Companies are required to update the economic forecasts that they use to measure ECLs at each reporting date by incorporating the reasonable and supportable information available at that time. The effort and sophistication required will depend on the company's exposures. ECLs are usually material for banks and other financial institutions and these companies are likely to face the greatest challenges and will need to put the most resources into updating ECLs to reflect changing conditions.

The following factors may be particularly relevant when measuring ECLs.

- The increased uncertainty about potential future economic scenarios and their impact on credit losses may require companies to explicitly consider additional economic scenarios when measuring ECLs.
- Existing ECL models will use historical experience to derive links between changes in economic conditions and customer behaviour, and ECL parameters such as loss rates, probabilities of default and loss given default. However, these historical relationships are unlikely to read across to the Covid-19 pandemic. Therefore, adjustments to model results, based on expert credit judgement, could be necessary to reflect the information available at the reporting date appropriately.
- Certain types of customers, industries or regions may be particularly severely affected by the economic effects of Covid-19. Companies with exposure to these customers, industries or regions will need to consider whether this is appropriately captured in their ECL measurements.
- Governments and central banks are launching measures to mitigate the adverse impact of Covid-19 on banks and borrowers. Companies may need to consider this when estimating ECLs.
- Many borrowers are drawing down credit lines or holding on to cash to obtain additional liquidity to help them weather the economic storms. This will be relevant for estimating exposures from loan commitments and prepayable or extendable loans.
- The expected cash flows used in measuring ECLs may also be affected by any actions planned by the company (e.g. modification, forbearance, limit extensions).
- In addition, limit increases for credit cards may impact the period of exposures assessed under paragraph 5.5.20 of IFRS 9.

Disclosures

A company is required to disclose the nature and extent of risks arising from financial instruments and how it manages those risks. Therefore, a company will need to explain the significant impacts of Covid-19 on the risks arising from financial instruments and how it is managing those risks. It will need to use judgement to determine the specific disclosures that are relevant to its business and necessary to meet these objectives.

Examples of specific disclosures include the following.

- Information about a company's credit risk management practices and how they relate to the recognition and measurement of ECLs. A company may have changed its risk management practices in response to Covid-19 – e.g. by extending debt relief to borrowers or by following specific guidance issued by governments or regulators.
- The methods, assumptions and information used to measure ECLs – e.g. a company may need to explain how it has incorporated updated forward-looking information into measuring ECLs, in particular:
  - how it has dealt with the challenge of ECL models that were not designed for the current economic shocks; and
  - how it has calculated overlays and adjustments to these models.
- Quantitative and qualitative information that allows evaluation of the amounts arising from ECLs; the types of analysis disclosed previously may need to be adjusted or supplemented to clearly convey impacts arising from Covid-19.
- Information on the assumptions that the company has made about the future and other major sources of estimation uncertainty at the reporting date that have a significant risk of resulting in material adjustment within the next financial year. [IAS 1.125]

Actions for management to take now

Consider the following when measuring ECL:

- whether additional economic scenarios are needed;
- whether adjustments to model results, based on expert credit judgement, are necessary;
- whether the measurement appropriately captures the types of customers/issuers or regions that are particularly impacted by the economic effects of Covid-19;
- changes in customer behaviour such as drawing more extensively on credit lines and holding on to cash;
- the impact of any assistance to borrowers from a government or regulator; and
- the impact of any actions planned by the company (e.g. modification, forbearance, limit increases) on the expected cash flows.

4-2- How has the credit risk of borrowers and other debtors been reassessed?

What's the issue?

Assessing credit risk – Identifying significant increases in credit risk and credit impairment

The assessment of credit risk – the risk of a borrower defaulting – is usually an integral part of measuring expected credit losses (ECLs) under IFRS 9 *Financial Instruments*. Except for some trade and lease receivables, a company needs to assess at each reporting date whether the credit risk on a financial instrument has increased significantly since initial recognition. If it has, then ECLs are recognised over the expected life of the exposure; if it has not, then ECLs are limited to those over the next 12 months of the life of the exposure. A company also needs to assess whether an exposure is credit-impaired. [IFRS 9.5.5.3]

Similar to other aspects of ECL measurement, assessing whether there is a significant increase in credit risk (SICR) since initial recognition is forward-looking and considers reasonable and supportable information that is available without undue cost or effort at the reporting date. [Insights 7.8.110.60]

The challenge for companies is to incorporate into the SICR assessment forward-looking information relating to the economic impact of the Covid-19 coronavirus outbreak that is available without undue cost or effort at the reporting date.

Companies are required to incorporate forward-looking information that is available without undue cost or effort into their assessment of whether credit risk on a financial instrument has increased significantly. This may be particularly challenging to do for the economic impact of Covid-19.

Getting into more detail

Identifying SICR is usually material for banks and other financial institutions. Many banks calculate explicit probabilities of default (PDs) for individual exposures and use these to perform quantitative assessments of SICR. They will need to consider whether they can incorporate Covid-19-related changes in the risk of default into PDs for individual exposures on a timely basis.

Companies also need to consider qualitative factors when identifying SICR. For example, changes in customer behaviour or requests for payment holidays or credit limit increases may indicate SICR or credit impairment.

If a company is not able to identify key drivers of credit risk on an individual instrument basis, then it may need to assess SICR on a collective basis. For example, it might need to consider whether, on the basis of the information available at the reporting date, credit risk has increased significantly for all or some borrowers in certain industries or regions and, if so, transfer all or a portion of those exposures to Stage 2 (or Stage 3 if they are credit-impaired).

Government assistance provided directly to borrowers might reduce the probability of a borrower defaulting and so avoid SICR occurring in some cases. However, when assessing whether credit risk has increased significantly, the probability of recovering cash flows under a financial guarantee that is integral to the terms of the financial asset is not considered. This means that expected recovery of loans to customers from government guarantees might be included in the measurement of ECLs, but this guarantee may not reduce the probability of default or avoid SICR occurring.

Sovereign exposures

Companies with exposures to governments, including investments in sovereign bonds, will need to update their measurements of ECLs and assessments of whether there is a significant increase in credit risk. Covid-19 is putting pressure on government finances and the pressure may become more intense over the coming months – this may impact the assessment of sovereign credit risk. The likelihood of SICR occurring in the near future will be elevated for sovereign exposures that are at the lower end of the investment grade rating range with a negative outlook.

Modifications and forbearance

As borrowers face greater risk of financial stress from the consequences of Covid-19, they might approach lenders to ask for concessions against the current terms of their borrowings. For example, they might request relaxation of covenants, delayed repayment of interest or principal, or a reduction in the interest rate. Governments might encourage banks to provide concessions for particular types of customers.

Both lenders and borrowers will need to analyse any such arrangements carefully to determine the appropriate accounting – i.e. they will need to assess whether:

- there has been a change in the contractual terms of a financial instrument and, if so, whether it leads to a derecognition gain or loss, or a remeasurement of its amortised cost; and
- for the lender, the arrangement indicates SICR or a credit impairment, or results in a partial write-off of the loan.

If a government provides assistance to a lender and this in turn enables the lender to provide support to its customers, then the lender will need to consider how to account for that assistance – in particular, whether government grant accounting under IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* is required. [Insights 7.8.130]

Disclosures

A company is required to disclose the nature and extent of risks arising from financial instruments and how it manages those risks. Therefore, a company will need to explain the significant impacts of Covid-19 on the risks arising from financial instruments and on how it is managing those risks. It will need to use judgement to determine the specific disclosures that are relevant to its business and necessary to meet these objectives.

Examples of specific disclosures include the following.

- How management determined whether the credit risk of the financial instrument has increased significantly since initial recognition. The methods and indicators used may have changed in response to the current conditions – e.g. additional collective assessments may have been performed or financial instruments may have been grouped differently.
- The methods, assumptions and information used to assess SICR – e.g. a company may need to explain how it has incorporated updated forward-looking information into assessing SICR.
- Quantitative and qualitative information that allows evaluation of the amounts arising from ECLs. The types of analysis disclosed previously may need to be adjusted or supplemented to clearly convey impacts arising from Covid-19.
- Information on the assumptions that the company has made about the future and other major sources of estimation uncertainty at the reporting date that have a significant risk of resulting in a material adjustment within the next financial year. [IAS 1.125]

Actions for management to take now

Consider:

- whether to incorporate Covid-19-related changes in the risk of default into PDs for individual exposures on a timely basis;
- incorporating qualitative factors in identifying SICR – e.g. changes in customer behaviour or requests for payment holidays or limit increases;
- assessing SICR on a collective basis;
- whether modification of contractual terms of a financial instrument leads to recognising a gain or loss on derecognition, or a gain or loss on remeasurement; and
- whether assistance provided by a government means that government grant accounting is appropriate.

4-3 - Are fair values appropriately determined?

What's the issue?

The Covid-19 coronavirus pandemic has significantly affected financial markets in the first quarter of 2020. Stock markets have declined sharply and volatility has increased. Treasury bond yields have reached record lows and credit-default-swap indices have been surging, reflecting concerns of increased corporate defaults. For many assets and liabilities, fair values may have changed significantly, reflecting changes in cash flow forecasts, higher uncertainty and elevated risks.

Fair value is a market-based measurement – it is measured using assumptions that market participants would use, reflecting market conditions at the measurement date. According to IFRS 13 *Fair Value Measurement,* a quoted price in an active market provides the most reliable evidence of fair value and if one is available then it has to be used to measure fair value. Use of hindsight or adjusting for what may be viewed as depressed pricing at the measurement date in light of subsequent changes in market prices is not permitted. [IFRS 13.77, 79]

Performing a valuation that uses significant unobservable inputs is challenging, especially at times, as now, when markets are volatile and the economic outlook is highly uncertain and may change quickly.

The fair value of an asset (or liability) should reflect market conditions at the measurement date. This has become more challenging due to the uncertainty of the economic impact of Covid-19.

Getting into more detail

'Unobservable inputs' are inputs for which market data is not available and that are developed using the best information available about the assumptions that market participants would make in pricing the asset or liability, including assumptions about risk. Unobservable inputs used in valuations may require significant adjustment to reflect the risks and uncertain market conditions at the measurement date. [IFRS 13.A]

Reflecting risks and market conditions at the measurement date

Some of the key factors and risks to consider when measuring fair value using a valuation technique include the following.

- **Economic activity levels.** Measures taken to contain the virus may lead to a significant reduction in economic activity in terms of production of and demand for goods and services, and may have a negative impact on forecast future cash flows used in a discounted cash flow valuation method.
- **Credit risk and liquidity risk**. The uncertain economic environment has resulted in increases in credit risk and liquidity risk for many companies. Own credit risk and/or counterparty credit risk used as inputs into valuation techniques may therefore increase.
- **Forecasting risk.** Fair value measurements should reflect the greater uncertainty in making economic and financial forecasts in the near term, due to the difficulty in forecasting the magnitude and duration of the economic impact of Covid-19.

- **Foreign exchange risk.** Companies with significant sales or purchases in foreign currencies may be adversely affected by exchange rate movements.
- **Commodity price risk.** Companies in extractive industries may be significantly affected by decreases in commodity prices. Companies in countries that are economically dependent on these commodities may also have greater risk of adverse economic impacts.

Significant judgment may be needed to quantify risk premiums and other adjustments for these risks. Also, the number of fair value measurements classified as Level 3 in the fair value hierarchy may increase (e.g. due to unobservable inputs such as the credit risk becoming significant in the current environment).

What do you need to disclose?

Annual reports
Given the impact of the increase in economic uncertainty on forecasting cash flows and other unobservable inputs used in valuation techniques (e.g. certain risk-adjusted discount rates), companies may need to provide sensitivity disclosures – together with disclosure of the key assumptions and judgements made by management – to enable users to understand how fair value has been determined. These disclosures are required under both IFRS 13 *Fair Value Measurement* and IAS 1 *Presentation of Financial Statements.* IFRS 13 also contains specific disclosure requirements when amounts are transferred into Level 3 of the fair value hierarchy, including sensitivity disclosures. [IFRS 13.93(e)(iv), 93(h), IAS 1.125, 129]

Interim reports
IAS 34 *Interim Financial Reporting* requires companies to provide many of the IFRS 13 disclosures on fair value measurement of financial instruments, including the sensitivity disclosures and significant transfers between levels in the fair value hierarchy. Additionally, IAS 34 requires companies to explain events and transactions that are significant to an understanding of the changes in a company's financial position and performance since the last annual reporting date. Therefore, fair value disclosures related to non-financial assets and non-financial liabilities are required if they are material to an understanding of the current interim period. This may be the case when fair values change significantly. [IAS 34.15, 16A(j)]

Actions for management to take now

Consider whether the valuation:

  - reflects market participants' assumptions based on information available and market conditions at the measurement date; and
  - incorporates the risk premiums that would arise from the increased uncertainty and other impacts of Covid-19.
- Consider whether unobservable inputs have become significant, which would result in a Level 3 categorisation and require additional disclosures.
- Consider expanding disclosures about the key assumptions, sensitivities and major sources of estimation uncertainty.

4-4 - How is hedge accounting impacted?

What's the issue?

The economic turbulence resulting from the COVID-19 coronavirus pandemic may affect a company's risk exposures and how it manages them.

If a company applies hedge accounting as part of its risk management strategy under IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 *Financial Instruments,* then it may need to consider whether:

- the hedge accounting criteria in IFRS® Standards continue to be met;
- there is hedge ineffectiveness to recognise in profit or loss; and
- amounts accumulated in a cash flow hedge reserve need to be reclassified to profit or loss.

The COVID-19 outbreak may affect when and how a company applies hedge accounting.

Getting into more detail

Changes to hedged transactions

Companies frequently enter into cash flow hedges of forecast transactions, such as purchases and sales of raw materials, and inventories. A forecast transaction can be designated as a hedged item only if it is highly probable to occur. This assessment needs to reflect the expectations at the reporting date. The COVID-19 outbreak is causing reductions in actual and forecast volumes of transactions in many regions and industries – e.g. jet fuel purchases. [IAS 39.88(c), IFRS 9.6.3.3]

If the COVID-19 outbreak reduces the probability of a hedged forecast transaction occurring or affects its timing, then the hedge accounting relationship may need to be terminated or there may be hedge ineffectiveness. Similarly, a reduction in the volume of highly probable forecast transactions may lead to partial termination under IFRS 9. [IAS 39.101(b), IFRS 9.6.5.6, B6.5.25, B6.5.27(b), BC6.317]

When a hedging relationship is discontinued because a forecast transaction is no longer highly probable, a company needs to determine whether the transaction is still expected to occur. If the transaction is:

- *still expected to occur,* then gains or losses on the hedging instrument previously accumulated in the cash flow reserve would generally remain there until the future cash flows occur; or
- *no longer expected to occur,* then the accumulated gains or losses on the hedging instrument need to be immediately reclassified to profit or loss. [IAS 39.101(b)–(c), IFRS 9.6.5.12(a)–(b)]

In addition, any changes to the contractual terms of a financial instrument resulting from the COVID-19 outbreak may affect the instrument's eligibility as a hedged item. For example, a bank may be applying fair value hedge accounting to term deposits whose terms and conditions include significant penalties in the case of early withdrawals. If a bank waives its right to penalties to allow customers to withdraw deposits early, then the contracts could be

viewed as demand deposits. This could mean that the hedging relationship is discontinued because there would be no fair value exposure to hedge. [IAS 39.AG118(b), BC87(d), IFRS 13.47]

Hedge effectiveness and ineffectiveness

A company considers the effect of changes in both counterparty credit risk and own credit risk when assessing hedge effectiveness and measuring hedge ineffectiveness. The increased credit risk arising from the COVID-19 outbreak could therefore affect both hedge effectiveness testing and the measurement of hedge ineffectiveness. [IAS 39.AG109, IFRS 9.B6.4.7]

For example, if a hedged financial asset becomes credit-impaired due to the outbreak, then the current hedging relationship is discontinued if the hedge no longer meets the applicable effectiveness requirements.

In addition, if there is an increase in the credit risk of a hedging instrument, then fair value changes due to the increased credit risk are not generally offset by changes in the value of the hedged item attributable to the hedged risk. This may lead to increased ineffectiveness or even failure of the effectiveness requirements.

Irrecoverability of losses in the cash flow hedge reserve

If the amount accumulated in the cash flow hedge reserve for a particular cash flow hedge is a loss and the company expects that all or a portion of that loss will not be recovered in future periods, then it immediately reclassifies to profit or loss the amount that is not expected to be recovered. The COVID-19 outbreak may increase the risk of this occurring. For example:

- a company is hedging future purchases of inventory and may not recover a loss on the hedging instrument through expected sales of those items; or
- a company hedged the purchase of a fixed-rate financial asset and may not recover a loss on the hedging instrument because the financial asset has become credit-impaired. [IAS 39.97–98, IFRS 9.6.5.11(d)(iii)]

Disclosures

When a company applies hedge accounting, it is required to disclose how it applies its risk management strategy and the effects on its financial performance and future cash flows. It is likely that the COVID-19 outbreak will affect these disclosures and a company will need to use judgement to determine the specific disclosures that are relevant and necessary for its business. [IFRS 7.21A]

Examples of specific disclosures include:

- changes in how the company manages risks;
- impacts on hedge ineffectiveness;
- forecast transactions that were subject to hedge accounting but are no longer expected to occur, and the related reclassifications to profit or loss; and
- reclassifications of irrecoverable losses from the cash flow hedge reserve to profit or loss. [IFRS 7.21A, 23E–23F, 24C(b)]

Actions for management to take now

- Evaluate whether forecast transactions designated as hedged items in cash flow hedges continue to be highly probable. If a transaction is not highly probable, then consider whether it is still expected to occur.
- Determine whether any changes in the contractual terms of a hedged financial instrument resulting from the COVID-19 outbreak affect the instrument's eligibility to be a hedged item.
- Evaluate whether changes in the credit risk of hedging instruments and hedged items arising from the COVID-19 outbreak affect the assessment of hedge effectiveness and the measurement of hedge ineffectiveness.
- Evaluate whether accumulated losses in the cash flow hedge reserve will be recovered in future periods.

4-5 - Does a contract still meet the own use exemption?

What's the issue?

A company may be required to account for a contract to buy or sell a non-financial item – e.g. commodities such as crude oil or metals – under IFRS® Standards for financial instruments as a derivative at fair value through profit or loss. [IFRS 9.2.4]

Financial instruments accounting applies if the contract can be settled net in cash or another financial instrument – which includes cases where the non-financial item is readily convertible into cash – unless the own use exemption applies. [IAS 32.8, IFRS 9.2.4]

The economic turbulence resulting from the COVID-19 coronavirus pandemic may mean that some of these contracts no longer qualify for the own use exemption.

The COVID-19 outbreak may affect when a company needs to account for a commodity contract as a derivative.

Getting into more detail

To qualify for the own use exemption, a contract to buy or sell a non-financial item needs to be entered into and *continue to be held* to receive or deliver that non-financial item in accordance with the company's expected purchase, sale or usage requirements. In addition, if a company has a past practice of settling similar contracts net in cash, then a contract would not satisfy the own use exemption. [IFRS 9.2.4, 2.6]

The COVID-19 outbreak may cause:

- a decline in business activity and subsequent decreases in a company's expected purchase, sale or usage requirements;
- disruptions to supply chains that may impair a company's or counterparty's ability to effect physical settlement; and
- sudden decreases in demand (or supply) that may cause contracts to be closed out or terminated through net cash settlement without delivery.

These circumstances may undermine a company's ability to apply the own use exemption:

- *for a particular contract,* if holding it is no longer consistent with reduced expected purchase, sale or usage requirements – e.g. if there is an expectation of net cash settlement rather than physical settlement; and
- *for a group of similar contracts,* if the company has settled some of them net in cash.

Judgement may be required to determine whether the company has developed a past practice of net settlement that precludes it from applying the own use exemption. This might not be the case if net settlements are infrequent and respond to events that could not have been foreseen at inception of the contract. [Insights 7.1.210.40]

In addition, a company needs to evaluate the notion of 'similar contracts' in the context of its own business practices. [Insights 7.1.210.50]

Actions for management to take now

Reassess whether derivative accounting may be required – i.e. because the own use exemption no longer applies – for sale and purchase contracts as a result of:

- decreases in expected sales, purchases or usage;
- expected net settlements arising from supply chain disruptions; or
- actual instances of net settlement.

4-6 - Have borrowers considered changes to the terms of their liabilities?

What's the issue?

Economic disruption following the COVID-19 coronavirus pandemic has caused financial burden for many borrowers. Therefore, they might approach lenders to ask for concessions on the current terms of their borrowings – e.g. request relaxation of covenants, delayed repayment of interest or principal, or a reduction in the interest rate. Governments might also encourage banks to provide concessions for particular types of customers. When debt terms are renegotiated, borrowers will need to analyse these arrangements carefully to determine the appropriate accounting.

If borrowers have received concessions on their liabilities, then different accounting might apply.

Getting into more detail

Modification

When the contractual terms of a financial liability are substantially modified, it is accounted for as an extinguishment of the original debt instrument and the recognition of a new financial liability. The new debt instrument is recorded at fair value and any difference from the carrying amount of the extinguished liability, including any non-cash consideration transferred, is recorded in profit or loss. Any costs or fees incurred are generally included in profit or loss, too. [IFRS 9.3.3.2–3.3.3, 5.1.1, B3.3.6]

If a modification to the terms of a financial liability is not substantial, then the amortised cost of the liability is recalculated as the present value of the estimated future contractual cash flows, discounted at the original effective interest rate. The resulting gains or losses are recognised in profit or loss. Any costs or fees incurred adjust the carrying amount of the modified financial liability and are amortised over its term. The periodic re-estimation of cash flows to reflect movements in market rates of interest will change the effective interest rate of a floating-rate financial liability. [IFRS 9.B3.3.6, B5.4.6, Insights 7.7.350]

To determine whether a modification of terms is substantial, a borrower performs a quantitative assessment – i.e. a '10 percent test'[1]. If the difference in the present values of the cash flows is less than 10 percent, then the borrower needs to perform a qualitative assessment to identify substantial differences in terms that by their nature are not captured by the quantitative assessment. Performing a qualitative assessment may require a high degree of judgement based on the facts and circumstances. [IFRS 9.B3.3.6, Insights 7.6.420.10–20]

Extinguishing liabilities with equity instruments

Borrowers might use their own equity instruments to settle their debt instruments (e.g. debt-for-equity swaps) because of the liquidity impact from the COVID-19 outbreak. If equity instruments are issued to a creditor to extinguish all or part of a financial liability in a debt-for-equity swap, then the equity instruments are consideration paid. [IFRIC 19.5]

The equity instruments are measured at fair value, unless that fair value cannot be measured reliably. In this case, the equity instruments are measured with reference to the fair value of the financial liability extinguished. When measuring the fair value of a financial liability extinguished that includes a demand feature, paragraph 47[2] of IFRS 13 *Fair Value Measurement* is not applied. [IFRIC 19.6–7]

The difference between the carrying amount of the financial liability and the fair value of the equity instruments is recognised in profit or loss. [IFRIC 19.9]

If only part of the financial liability is extinguished by the issue of equity instruments, then a borrower needs to assess first whether a part of the consideration is for a modification of the liability still outstanding. If it is, then the consideration paid is allocated between the extinguished part and the part that remains outstanding. The consideration allocated to the debt still outstanding forms part of the assessment of whether the modification is substantial. All relevant facts and circumstances need to be taken into account in making this allocation [IFRIC 19.8, 10, Insights 7.6.450.40–50]

Support from governments

See our related web articles for further guidance on how government assistance should be accounted for:

- Are **government grants** recognised in the right period and appropriately measured?
- How should companies account for different forms of **government assistance**?

Actions for management to take now

Management needs to consider:

- whether there are any changes to the terms and conditions of a financial liability and, if so, whether those changes are substantial;
- if equity instruments have been issued to settle all or part of a financial liability, whether the fair value of those equity instruments can be measured reliably; and
- if an equity instrument has been issued to settle part of a financial liability, whether part of the consideration is for the modification of the liability still outstanding.

1 Terms are considered to have been 'substantially modified' when the net present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, differs by at least 10 percent from the present value of the remaining cash flows under the original terms.

2 The fair value of a financial liability with a demand feature (e.g. a demand deposit) is not less than the amount payable on demand, discounted from the first date on which the amount could be required to be paid.

4-7 - How are expected credit losses on trade receivables impacted? New

What's the issue?

IFRS 9 *Financial Instruments* introduced changes to the calculation of bad debt provisions on trade receivables. Previously, companies provided for amounts when the loss had actually occurred. Under IFRS 9, companies are required to account for what they *expect* the loss to be on the day they raise the invoice – and they revise their estimate of that loss until the date they get paid. The concept of *expected* credit losses (ECLs) means that companies are required to look at how current and future economic conditions impact the amount of loss. Credit losses are not just an issue for banks.

ECLs on trade receivables are measured by applying either the general model or the simplified model. This article considers issues particularly relevant to the simplified model, in which ECL is measured at an amount equal to lifetime ECL. For application of the general model, see the following web articles:

- How have economic forecasts used to measure expected credit losses been updated?
- How has the credit risk of borrowers and other debtors been reassessed?

Companies using the simplified model often use provisioning matrices that are based on historical data. Those matrices will have to be adjusted to incorporate reasonable and supportable information that is available at the reporting date, including the impact of the COVID-19 coronavirus outbreak. This may include additional scenarios and the impact of any government support schemes.

In addition, certain assumptions used in the ECL estimate – e.g. about segmentation of a portfolio or the effective interest rate used to discount expected future cash flows – may no longer be appropriate and so may need revising.

Companies will need to update provision models to reflect increased credit losses arising from COVID-19.

Getting into more detail

Reflecting information available at the reporting date

ECLs are measured at an unbiased, probability-weighted amount, using reasonable and supportable information that is available without undue cost or effort at the reporting date. This includes information about past events, current conditions and forecasts of future economic conditions. Because of the short-term nature of trade receivables, many companies may not have needed to consider updating ECL estimates for changes in future economic conditions relative to historic experience. However, they may now need to revisit this given the severe economic impacts of the COVID-19 outbreak. Also, companies may need to consider a longer time horizon – e.g. when payment dates are deferred for a significant period. [IFRS 9.5.5.17]

IFRS 9 allows the use of practical expedients when measuring ECLs under the simplified approach – e.g. using a provision matrix. A company that applies a provision matrix may be applying segmentation to capture the significantly different historical credit loss experience for different customer segments. However, the segmentation applied in previous periods may no longer be appropriate and may need to be revised to reflect the different ways in which the COVID-19 outbreak affects different types of customers.

Provision matrices are based on historical loss experience but should be adjusted to reflect information about current conditions and reasonable and supportable forecasts of future economic conditions. The COVID-19 outbreak may lead to a significant increase in the loss rate for trade receivables. Therefore, companies will need to consider how the timing and amount of cash flows generated by outstanding trade receivables might be affected and increase loss rates as necessary.

Companies that have credit insurance for their trade receivables should consider how this affects the measurement of ECL and ensure that measurement is consistent with updated loss estimates and any limitations on coverage. The accounting will depend on whether the insurance is considered to be a financial guarantee integral to the contractual terms of the trade receivable. If the guarantee is integral, then it will be included in the measurement of ECL on the trade receivable. If it is not, then separate accounting considerations will apply depending on whether the loss event has occurred. [Insights 7.1.132, 139–140]

Discount rate

Trade receivables without a significant financing component are measured on initial recognition at the transaction price determined under IFRS 15 *Revenue from Contracts with Customers*, and do not have a contractual interest rate. This implies that the effective interest rate for these receivables is zero. Accordingly, discounting of cash shortfalls to reflect the time value of money when measuring ECLs is generally not required.

However, if a trade receivable becomes overdue and is then modified to effectively incorporate a significant financing component, then further analysis and judgement may be required, because using an effective interest rate of zero may no longer be appropriate. There may be more

renegotiations of trade receivables given the economic impacts of the COVID-19 outbreak. [Insights 7.8.400.30]

Disclosures

Under IFRS 7 *Financial Instruments: Disclosures*, a company is required to disclose the nature and extent of risks arising from financial instruments and how it manages those risks. Therefore, a company will need to explain the significant impacts of the COVID-19 outbreak on the risks arising from financial instruments, including trade receivables, and how it is managing those risks. It will need to use judgement to determine the specific disclosures that are both relevant to its business and necessary to meet these disclosure objectives. [IFRS 7.31]

Examples of specific disclosures include the following.

- Information about a company's credit risk management practices and how they relate to the recognition and measurement of ECLs. A company may have changed its risk management practices in response to the COVID-19 outbreak – e.g. by extending payment terms for trade receivables or by following specific guidance issued by governments in relation to the collection of lease or other payments.
- The methods, assumptions and information used to measure ECLs – e.g. a company may need to explain how it has incorporated updated forward-looking information into measuring ECLs; in particular, how it has:
  - dealt with the challenge of *simplified* ECL models that were not designed for the current economic shocks;
  - calculated any overlays and adjustments to these *simplified* models;
  - reflected the impact of any credit insurance; and
  - incorporated the provision of government support that might aid recovery of balances.
- Quantitative and qualitative information that enables evaluation of the amounts arising from ECLs. The types of analysis disclosed previously may need to be adjusted or supplemented to clearly convey impacts arising from the COVID-19 outbreak.
- Information on the assumptions that the company has made about the future and other major sources of estimation uncertainty at the reporting date that have a significant risk of resulting in material adjustment within the next financial year. [IFRS 7.35F, 35H–L, IAS 1.125]

Actions for management to take now

When measuring ECLs for trade receivables:

- assess how to incorporate forward-looking information about the impacts of the COVID-19 outbreak;
- consider whether the segmentation applied to measure ECL appropriately captures the different types of customers or regions that are affected in different ways by the economic effects of the COVID-19 outbreak;
- assess whether a trade receivable has been modified and if so whether it continues to be appropriate to use a discount rate of zero; and
- consider how to incorporate the impact of any credit insurance and government support.

5- Employee benefits: what is the impact on employee benefits?

5-1- Have there been changes to employee benefits and employer obligations?

What's the issue?

In responding to the significant deterioration in economic conditions and increased uncertainty as a result of the Covid-19 coronavirus, companies may make changes to or introduce new remuneration policies.

The accounting implications of these changes under IFRS® Standards, including any employee termination plans, will require careful consideration.

These events may also impact how companies:

- **measure employee benefits** – e.g. updated actuarial valuations of defined benefit liabilities might be required; and
- **recognise share-based payment expenses** – e.g. companies may need to revise the estimates used to recognise these expenses and consider the implications of any modifications to these arrangements.

Market volatility and changes to remuneration policies may impact how companies estimate and measure employee benefits and recognise share-based payment expenses

Getting into more detail

Changes to remuneration policies

Some companies may offer their employees paid absence in addition to any sick or annual leave entitlement. If new paid absence entitlements do not accrue through past service and do not accumulate, then it is unlikely that a company would recognise a liability for these paid absences. Instead, it would expense the cost as absences are taken. Companies will need to consider, more generally, whether they have any legal or constructive obligations to its employees as a result of these events. [IAS 19.13, Insights 4.4.1250]

If a company implements a restructuring plan that includes employee redundancies, then it recognises an expense and a corresponding liability for termination benefits at the earlier of when it:

- recognises a restructuring provision under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* that includes the payment of termination benefits; and
- can no longer withdraw the offer of those benefits. [IAS 19.165, Insights 4.4.1460]

A company recognises a restructuring provision when it has a formal plan with sufficient detail of the restructuring and has raised a valid expectation in those affected by the plan – i.e. it has either started to implement the plan or has announced the main features to those affected by it. [IAS 37.72, Insights 3.12.230]

Updating estimates, including actuarial assumptions

Companies may need to consider the potential impact on estimates, including actuarial assumptions used in measuring employee benefits.

During periods of mandatory quarantine or lockdowns, employees could be required to use existing employee entitlements – e.g. sick or annual leave entitlements. Therefore, companies may need to consider the impact on the measurement of employee benefits – e.g. they may need to revise estimates of the likelihood and timing of employees using these entitlements.

There could also be an impact on certain demographic and financial assumptions used to measure these benefits – e.g. the discount rate used to measure the present value of employee benefit obligations.

Companies preparing interim financial statements should consider whether net defined benefit obligations/assets need to be remeasured. Under IAS 19 *Employee Benefits,* remeasurements are recognised in the period when they arise; therefore, if adjustments at the interim reporting date are considered to be material, then they will need to be recorded at that date. An updated measurement of plan assets and obligations is required when a plan amendment, curtailment or settlement is recognised. In addition, significant market fluctuations may trigger the need for an updated actuarial valuation. [IAS 34.IE.B9, Insights 4.4.360, 5.9.150]

Practically, many companies obtain actuarial valuations a few months before the reporting date. This is acceptable if the valuation is adjusted for material subsequent events up to the reporting date. Therefore, companies should consider the timing of their actuarial valuation reports and whether they reflect material events between the valuation and reporting date. [Insights 4.4.350]

Share-based payments

Companies with share-based payments whose vesting depends on achieving non-market performance conditions – e.g. earnings per share targets – may need to revise their estimate of the number of instruments expected to vest, which would impact the charge in the income statement over the remaining vesting period. However, expectations of achieving market performance conditions – e.g. achieving a specified total shareholder return and non-vesting conditions – and grant-date fair value are not revised. [Insights 4.5.500]

Modifications to share-based payment arrangements will need to be assessed as to whether they are either beneficial or non-beneficial to the employee and accounted for accordingly. For example, if plans are modified such that market conditions are easier to achieve, then this may constitute a beneficial modification which increases the value of the award in the hands of the employee. In this case, the incremental fair value is recognised over the modified vesting period. [Insights 4.5.1190]

Actions for management to take now

- Consider the appropriate accounting for new employee benefit arrangements – e.g. new remuneration policies.

- Assess when to recognise an expense and corresponding liability for termination benefits.
- Update estimates, including actuarial assumptions used to measure employee benefits, as appropriate.
- In preparing interim financial statements, consider the need for updated actuarial valuation reports and whether any plan remeasurements should be recognised.
- For any actuarial valuation reports obtained before the reporting date, consider how to reflect material events occurring between the valuation and reporting dates.
- Update the estimate of the number of awards that will vest for achieving non-market performance conditions in share-based payment arrangements.
- Evaluate whether modifications to share-based payment arrangements are non-beneficial or beneficial.

6- Government assistance: How should government assistance be accounted for?

6-1- Are government grants recognised in the right period and appropriately measured?

6-2- How should companies account for different forms of government assistance?

6-1- Are government grants recognised in the right period and appropriately measured?

What's the issue?

Governments around the world are responding to the Covid-19 coronavirus outbreak by implementing a variety of measures to provide relief to companies and stimulate the economy. Government assistance that meets the definition of a government grant is accounted for under the specific requirements of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance.*

Companies need to evaluate all of the government assistance they may receive to determine the appropriate accounting – for example, by asking the following questions.

- Does the assistance meet the definition of a government grant?
- When should the grant be recognised?
- How should the grant be measured and presented in the financial statements?

Companies that have not previously received government grants may need to develop new accounting policies and procedures, and significant judgement may be required to address newly implemented government programmes.

Significant judgement may be required to determine when and how to recognise new government assistance programmes.

Getting into more detail

Identifying government grants

IFRS® Standards include accounting requirements specifically for government assistance in the form of a government grant. Therefore, companies need to consider the distinction between government grants and other forms of assistance carefully. IAS 20 defines a government grant as a transfer of resources in return for past or future compliance with certain conditions relating to the operating activities of the company.

Government grants may come in many forms. For example, companies may receive grants in the form of forgivable loans, below-market interest rate loans, waivers of expenses, non-monetary assets and other subsidies. However, government assistance in the form of

benefits that are available when determining taxable profit or tax loss, or are determined on the basis of a company's income tax liability, are not in the scope of IAS 20. [Insights 4.3.10]

Accounting for government grants

A company recognises a government grant when it has reasonable assurance that it will comply with the relevant conditions and the grant will be received. This may be a judgemental matter, particularly when governments are introducing new programmes that may require new legislation, or for which there is little established practice for assessing whether the conditions to receive a grant are met.

If the conditions are met, then a company recognises government grants in profit or loss on a systematic basis and in line with its recognition of the expenses that the grants are intended to compensate. Companies need to consider the conditions associated with the grant carefully to determine whether it compensates expenses already incurred or future costs. [Insights 4.3.40]

Measurement and presentation of government grants depends on the nature of the grant and the company's accounting policies. For example, companies may need to develop accounting policies for:

- grants in the form of non-monetary assets – whether to measure at nominal or fair value [Insights 4.3.50];
- grants related to assets – whether to deduct the grant from the cost of the asset (net presentation) or present the grant separately as deferred income to be amortised over the useful life of the asset (gross presentation) [Insights 4.3.130]; and
- grants related to income – whether to offset the grant against the related expenditure or to include it in other income. [Insights 4.3.140]

Actions for management to take now

- Monitor government actions and legislation to identify all assistance that may meet the definition of a government grant.
- Develop accounting policies and procedures for government grants.
- Consider expanding disclosures on the accounting policies for government grants and the impact of grants and other assistance on the financial statements. [IAS 20.39]

6-2- How should companies account for different forms of government assistance?

What's the issue?

Governments around the world are considering a broad range of possible actions to provide assistance to companies in the current conditions caused by the COVID-19 coronavirus pandemic.

Under IFRS® Standards, the accounting for government assistance depends on the nature of the assistance. The requirements of the standards differ significantly on when to recognise that assistance and how to measure it. Companies therefore need to identify which specific standard applies to determine the appropriate accounting.

Accounting for government assistance will differ significantly depending on its nature and type – e.g. whether it is a grant, loan, tax benefit or guarantee. Identifying the specific accounting requirements that apply will be crucial.

Getting into more detail

The accounting treatment of some common forms of government assistance is as follows. This list is not exhaustive.

Government grants

A **government grant** is a transfer of resources in return for past or future compliance with certain conditions relating to a company's operating activities. A company applies IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* to account for government grants.

Under IAS 20, a company recognises a government grant when it has reasonable assurance that it will comply with the relevant conditions and the grant will be received. A company recognises a government grant in profit or loss on a systematic basis and in line with its recognition of the expenses that the grant is intended to compensate. [Insights 4.3.40]

Income taxes

Government assistance in the form of benefits that may impact a company's taxable profit or its income tax liability – e.g. tax reliefs for certain types of income, additional tax deductions, a reduced tax rate or an extended period to use tax losses carried forward – are generally accounted for under IAS 12 *Income Taxes*, not IAS 20.

For example, if a government plans to amend income tax legislation to reduce corporate tax rates, then a company recognises and measures the effect of the amendment in accordance with the detailed requirements of IAS 12. This includes considering whether any deferred tax assets are **recoverable** . A company accounts for the change in tax rate only when the amendment to the legislation is substantively enacted. [Insights 3.13.480]

Government ownership interests

Government participation in the ownership of a company is not itself in the scope of IAS 20. For example, if a government acquires an ownership interest in a subsidiary, then the parent company applies IFRS 10 *Consolidated Financial Statements* to assess whether it should continue to consolidate the subsidiary or, if appropriate, to account for a disposal or partial disposal.

If a government provides support to a company and is also a shareholder in that company, then the company needs to assess whether the government is acting in its capacity as shareholder or as government. This will determine how the company accounts for the government support. [Insights 4.3.10]

Supplies of goods and services

Transactions with governments that cannot be distinguished from the normal trading activities of a company are not government grants.

For example, if a company supplies goods or services to a government that are an output of its ordinary activities, then it will generally apply IFRS 15 *Revenue from Contracts to Customers*. This will include accounting for revenue only when the **contract existence** criteria in IFRS 15 are met.

Government loans and guarantees

A company generally accounts for the benefit of a government loan at a below-market interest rate as a government grant under IAS 20. It accounts for the loan in accordance with IFRS 9 *Financial Instruments*. The benefit that is the government grant is measured as the difference between the fair value of the loan on initial recognition and the amount received. Similar considerations apply to a government guarantee of a new loan issued by a company.

For example, suppose a company issues a loan that is guaranteed by government. The company receives proceeds of 100 from the lender. The fair value of the loan without the government guarantee is 90. On initial recognition, the company records a financial liability measured at 90 and a government grant measured at 10.

Disclosure

Companies apply the disclosure requirements in the applicable standards. For example, if a company receives a government loan at a below-market interest rate, then it provides the disclosures required by IAS 20 and those required by IFRS 7 *Financial Instruments: Disclosures*. If a government is also a shareholder, then additional related party disclosures may be required under IAS 24 *Related Party Disclosures.*

Additional disclosures explaining the company's use of government assistance may also be needed under IAS 1 *Presentation of Financial Statements.*

Actions for management to take now

- Prepare an inventory of each form of government assistance that the company receives or hopes to receive.
- Determine which standard will apply to each form of government assistance, noting that more than one standard may apply to some transactions.
- Develop relevant accounting policies, focusing on when the government assistance is recognised and how it is measured, noting that the recognition date may be different for different forms of government assistance.
- Prepare draft disclosures as required by each relevant standard.
- Consider the need for overarching disclosures about the company's use of government assistance and the impact of measures taken by governments in its assessment of **going concern**.

7- Revenue: what is the impact on revenue-cycle accounting?

7-1 - Are customer contracts still enforceable?

7-2 - Are revenue estimates up to date – e.g. variable consideration, measure of progress?

7-3 - How should companies account for insurance proceeds? NW

7-1- Are customer contracts still enforceable?

What's the issue?

The impacts of the COVID-19 coronavirus outbreak may call into question the ability of companies, and their customers, to abide by the stated terms of their contracts. This may affect the timing and amount of revenue to be recognised – or whether revenue should be recognised at all.

For example, companies may need to consider the following.

- Customers may now struggle to meet their contractual obligations. Does this mean that companies should stop recognising revenue for existing contracts and not recognise revenue for new contracts?
- Rights to payment for performance to date may not be enforceable – e.g. due to force majeure or similar clauses being invoked. Does this affect whether revenue can be recognised over time?
- Companies and their customers may seek to change the terms of existing contracts to respond to the impacts of the COVID-19 outbreak on their business. How should companies account for these contract modifications?

Determining whether rights and obligations are enforceable may require significant judgement and regular reassessment. As circumstances continue to change, companies should monitor the enforceability of their contract terms closely.

Uncertainty about whether the rights and obligations in customer contracts remain enforceable may affect the timing and amount of revenue to be recognised.

Getting into more detail

Contract existence

Under IFRS 15 *Revenue from Contracts with Customers*, companies account for a contract with a customer only when the agreement creates enforceable rights and obligations under the law. That is, a company recognises revenue if, and only if, the contract passes the contract existence test in Step 1 of the **five-step model for revenue recognition** .

When entering into new contracts, companies need to consider carefully whether these Step 1 criteria are met. For example:

- Are both parties committed to performing their respective obligations?
- Is it probable that consideration will be collected?
- Does the contract allow each party to terminate a wholly unperformed contract without compensating the other party? [IFRS 15.9–12, Insights 4.2.30]

If a new contract with a customer does not meet all of the contract existence criteria, then a company does not recognise revenue.

In addition, companies may need to reassess whether the contract existence criteria continue to be met for existing contracts – i.e. if there is a significant change in facts and circumstances. If an existing contract with a customer no longer meets these criteria, then a company stops recognising revenue for that contract. [IFRS 15.13]

Revenue recognition over time

Some companies recognise revenue over time under paragraph 35(c) of IFRS 15 – i.e. the company's performance does not create an asset with an alternative use and it has an enforceable right to payment for performance to date.

This is common in sectors such as real estate, construction, engineering, aerospace and defence. However, this approach is not a choice – it is available under paragraph 35(c) only when the company has an enforceable right to payment.

Companies should consider carefully whether this right to payment continues to be enforceable in the current conditions. For example, if courts cease to uphold rights to payment, or force majeure or similar clauses are being invoked, then these rights may no longer be enforceable. Significant judgement may be required in making this assessment. [IFRS 15.35–37, Insights 4.2.220]

If this criterion for recognising revenue over time is no longer met, and the other over-time criteria in paragraph 35 are not met, then companies recognise revenue at a point in time. For example, a construction company that spends two years building an apartment block would recognise revenue no earlier than when it completes construction. [IFRS 15.32]

Contract modifications

Companies and their customers may seek to modify existing contracts to respond to the impacts of COVID-19 on their business. Under IFRS 15, a contract modification is a change in the scope or price of a contract, or both. This may be described as a change order, a variation or an amendment.

Companies account for contract modifications when they are approved and when they create or change the enforceable rights and obligations of the parties to the contract. Companies may need to exercise judgement to assess when contract modifications are approved, particularly when contracts are modified frequently or there is continuing uncertainty about how a contract will be completed. [IFRS 15.18]

Accounting for contract modifications can be complex. There are different approaches for different circumstances, depending on factors such as how the modification is priced and whether the current contract is being accounted for over time. Companies need to apply the specific requirements in IFRS 15. [IFRS 15.20–21, Insights 4.2.290]

Disclosures

In annual financial statements, companies are required to disclose judgements made, and changes in those judgements that significantly affect the amount and timing of revenue recognised. For example, companies may need to provide or update disclosures about when the contract existence criteria are met or whether revenue is recognised over time under paragraph 35(c). [IFRS 15.123]

In interim financial statements, IFRS 15 requires companies to include information about disaggregated revenue. However, companies need to consider whether to provide other disclosures for revenue to meet the requirements in IAS 34 *Interim Financial Reporting* – e.g. if there is a change in a company's accounting policies for revenue.

Actions for management to take now

- Consider whether contracts meet Step 1 of the IFRS 15 model – e.g. do contracts meet the existence criteria?
- When revenue is being recognised over time under paragraph 35(c), determine whether rights to payment for performance to date remain enforceable.
- Assess whether existing contracts have been modified and account for these modifications when they are approved.
- Disclose significant judgements and changes in judgements made in applying IFRS 15.

7-2- Are revenue estimates up to date – e.g. variable consideration, measure of progress?

What's the issue?

Under IFRS 15 *Revenue from Contracts with Customers,* determining the timing and amount of revenue to be recognised often requires a company to make estimates and judgements. The COVID-19 coronavirus outbreak has disrupted many industries and created uncertainties that may affect these estimates significantly.

For example, companies may need to consider the following.

- To boost demand, are customers being offered new incentives that would reduce the estimated amount of revenue?
- When contracts include variable consideration, are there changes in the estimated amount of revenue?
- Do estimated stand-alone selling prices need to be updated for new contracts?
- When revenue is recognised over time, does the estimated progress towards completion reflect the latest expectations?

Companies need to update these estimates to reflect the current environment, which may require significant judgement.

Revenue estimates need to be updated to reflect the latest expectations, which may impact the timing and amount of revenue recognised.

Getting into more detail

Identifying variable consideration

Under IFRS 15, if a contract includes variable consideration, then a company estimates the amount of consideration to which it will be entitled. Variable consideration includes discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties and other similar items. It may be explicit or implicit – e.g. based on the company's customary business practices or specific statements.

Companies need to consider carefully whether actions taken to respond to the COVID-19 outbreak result in additional variable consideration – e.g. incentives or concessions offered to customers. Additionally, if a company's supply chain or labour force is disrupted such that it cannot satisfy its obligations, then this could result in penalties that reduce the transaction price. [IFRS 15.50–52]

Estimating variable consideration

A company estimates variable consideration but includes it in the transaction price only to the extent that it is highly probable that a significant reversal of revenue will not occur ('the constraint'). [IFRS 15.56]

A company's estimate of the constrained amount may be impacted significantly by COVID-19. For example, falling demand may impact whether customers will qualify for rebates or

volume discounts. Further, transport companies may need to update estimated revenue for an increase in refunds to customers for cancelled or delayed journeys.

Companies need to reassess the estimated transaction price at each reporting date. [IFRS 15.59]

Stand-alone selling prices

Under IFRS 15, a company allocates the transaction price to each performance obligation identified on a relative stand-alone selling price basis. The stand-alone selling price is the price at which a company would sell a promised good or service separately to a customer. When the stand-alone selling price is not directly observable, a company estimates it considering all reasonably available information and maximising the use of observable inputs. [IFRS 15.74, 77–78]

COVID-19 may impact these estimates significantly, either because observable selling prices change or because inputs to estimate techniques change. This may in turn affect the amount of revenue recognised as each good or service in the contract is transferred.

Companies need to ensure they use up-to-date estimates to allocate the transaction price for new contracts. However, after contract inception the transaction price is not reallocated to reflect subsequent changes in stand-alone selling prices. [IFRS 15.88]

Revenue recognition over time

When a company transfers control of a good or service over time, revenue is recognised by measuring the progress towards complete satisfaction of that performance obligation. This is common in sectors such as real estate, construction, engineering, aerospace and defence. A company applies a single method of measuring progress to depict its performance in transferring control of goods or services, using an output or an input method. [IFRS 15.39–41]

When a company uses an input method to measure progress – e.g. costs incurred as a percentage of expected total costs – it needs to estimate the total expected inputs that will be needed to satisfy the performance obligation. COVID-19 may impact project timelines if work cannot be completed to schedule. It may also push up the costs of key inputs.

Companies need to ensure that the estimated progress and revenue recognised reflect the latest expectations. Any changes in this estimate are accounted for prospectively.

Disclosures

In annual financial statements, companies are required to disclose information about the methods, inputs and assumptions used for estimating variable consideration (including the constraint) and estimating stand-alone selling prices. Companies may need to expand or update these disclosures for the impact of COVID-19. [IFRS 15.126]

In interim financial statements, companies need to include information about disaggregated revenue. However, companies should consider whether to provide other disclosures for revenue to meet the requirements in IAS 34 *Interim Financial Reporting* – e.g. if there is a change in a company's accounting policies for revenue.

Actions for management to take now

- Evaluate whether contracts include variable consideration – e.g. customer incentives or penalties for delayed performance.
- Update estimates of variable consideration, including the constraint.
- Assess whether estimated stand-alone selling prices need to be updated.
- When revenue is recognised over time using an input method, evaluate whether the progress towards satisfaction reflects the latest expected total inputs.
- Disclose information about the methods, inputs and assumptions used for estimating variable consideration and stand-alone selling prices.

7-3 - How should companies account for insurance proceeds?

What's the issue?

Some companies may have insurance cover for losses triggered by the COVID-19 coronavirus outbreak – e.g. for business interruption or third party claims, including penalties for non-performance, late delivery or cancellations.

For many companies, accounting for insurance proceeds will be a new area. In many cases, the key question is when is it appropriate to recognise the expected proceeds from an insurance claim? To determine this, companies need to consider the nature and timing of the insured event.

The accounting for insurance proceeds related to losses triggered by the COVID-19 outbreak depends on the nature and timing of the insured event.

Getting into more detail

Under IFRS® Standards, the accounting for insurance proceeds depends on whether a company recognises a provision for the insured event.

Reimbursements

As a result of the COVID-19 outbreak, some companies may struggle to fulfil their legal or contractual obligations and may incur penalties that give rise to a **provision**. Insurance proceeds may reimburse some or all of the expenditure necessary to settle the provision.

Insurance proceeds to settle a provision are accounted for as reimbursements under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and are recognised as a separate asset (with related income) when recovery is virtually certain. The amount recognised as a reimbursement right is limited to the amount of the related provision. [IAS 37.53]

Compensation for business interruption

Insurance proceeds may compensate a company for business interruption – e.g. for lost profits caused by COVID-19. The ability to claim these proceeds will depend on the specific terms of the insurance contract, actions taken by the government and interpretation of the

applicable law. For example, if all restaurants are ordered to close by the government, then they may be able to claim under their insurance contracts.

Lost profits, by themselves, do not give rise to a provision. Therefore, compensation for business interruption is not a reimbursement right under IAS 37 and should be accounted for by analogy to guidance on compensation for impairment under IAS 16 *Property, Plant and Equipment*. Following that guidance, a company recognises the compensation for business interruption as a receivable when it has an unconditional right to receive the compensation.

A company would have an unconditional contractual right to receive compensation if:

- it has an insurance contract under which it can make a claim for compensation; and
- the loss event that creates a right for the company to assert a claim at the reporting date has occurred and the claim is not disputed by the insurer. [Insights 3.12.198.10]

The compensation receivable would be measured based on the amount and timing of the expected cash flows discounted at the rate that reflects the credit risk of the insurer. [IAS 16.65–66, Insights 3.12.195.15 and 198.10]

Actions for management to take now

- Review insurance contract terms and, involving legal advisers where necessary, determine eligibility to claim under insurance contracts for losses caused by the COVID-19 outbreak.
- Assess whether any business interruption triggers **impairment of assets** and perform the impairment test if necessary.
- Recognise a reimbursement for a provision as a separate asset only when it is virtually certain that the company will receive it.
- Recognise a receivable only when there is an unconditional right to receive the compensation for business interruption.

8- Leases: Have been changes made to lease contracts?

8-1 - How should companies account for rent concessions?

8-2 - Have expectations around lease renewal, termination or purchase options changed?

8-1 - How should companies account for rent concessions?

What's the issue?

Due to the impact of the COVID-19 coronavirus outbreak on trading conditions, many lessees are seeking rent concessions from lessors. Rent concessions may take the form of a one-off reduction in rent, a reduction for a defined period of time or a change in the nature of rent – e.g. fixed rent payments becoming variable. For example, a number of retailers are seeking reductions in real estate rents – though similar issues may arise in other leases.

The accounting implications of an agreed change to rents can be very different depending on whether the change was envisaged in the original lease agreement:

- a rent concession not envisaged in the original lease agreement will often be a lease modification, requiring the lessee to remeasure lease assets and lease liabilities, and the lessor to revise its operating lease income over the remaining lease term; but
- the application of an existing contractual mechanism to adjust rent may represent a variable lease payment, resulting in an adjustment to lease income/expense in the period in which it arises.

Other considerations may apply if the lessee defaults on the lease or governments intervene to provide relief to lessors or lessees.

Significant judgement may be required to determine how to account for rent concessions in real estate and other leases.

Getting into more detail

Determining the nature of a rent concession

To account for a rent concession under IFRS 16 *Leases,* companies first need to determine the nature of the rent concession.

Many rent concessions will meet the definition of a lease modification – i.e. a change in scope or consideration that was not part of the original terms and conditions of the lease. When this is the case, companies apply the detailed guidance in IFRS 16 on accounting for lease modifications (see below).

In other cases, the original terms and conditions of the lease may include a mechanism to adjust rents if certain events occur. When this is the case, the rent concession will often represent a variable lease payment. Companies generally account for variable lease payments as income or expense in the period in which they arise.

Accounting for a rent concession that is a lease modification

To take a simple example, suppose a retailer leases a store from a landlord for a fixed term. The landlord classifies the lease as an operating lease. The retailer and landlord negotiate a change in the terms and conditions of the lease, so that the fixed rent is reduced by 50% for the next 12 months. There are no other changes to the lease.

The retailer and landlord account for this rent concession as follows.

- The retailer recalculates its lease liability, by discounting the new rent at a revised discount rate determined at the date the lease modification was agreed. The retailer adjusts the right-of-use asset by the amount of the resulting change in the lease liability.
- The landlord recalculates the straight-line operating lease income that it will recognise over the remaining term of the lease, based on the reduced rents. The landlord includes in this calculation any prepaid or accrued rents at the date the lease modification is agreed.

Accounting for lease modifications can be complex. Further guidance is available in our publication **Lease modifications.**

Other scenarios

In some cases, the government may intervene to provide support to lessees or lessors. When this is the case, companies should consider the guidance in IFRS® Standards on **government assistance**.

In addition, lessors should consider whether:

- operating lease receivables are **impaired**;
- underlying assets measured at cost are **impaired**; and
- underlying assets measured at fair value – e.g. investment property measured at **fair value** – are appropriately measured.

Disclosures

Companies are required to disclose information about the effect that leases have on their financial position, financial performance and cash flows – including information about variable lease payments recognised as income/expense in the period. [IFRS 16.51, 89]

Actions for management to take now

- Review existing lease contracts to identify whether they contain rent adjustment clauses that may be triggered in the current conditions.
- Develop processes for real estate teams to report rent concessions to the finance function as they are negotiated and agreed.
- Identify and document key judgements made – e.g. in assessing the nature of the rent concession and, where relevant, determining the revised discount rate.
- Consider expanding disclosures on the accounting impact of rent concessions as a result of the outbreak.

8-2 - Have expectations around lease renewal, termination or purchase options changed?

What's the issue?

The COVID-19 coronavirus pandemic is significantly affecting economic activity and sentiment around the world, with disruption to business operations, supply chains and production lines.

Companies are making business decisions that affect their lease contracts in response to uncertainty caused by COVID-19. As a result, lease contracts containing renewal and termination clauses may need to be reassessed to determine whether there is any change to the lease term. Any changes in the lease term could have a significant impact on the carrying amount of lease assets and liabilities.

Further, lease contracts with purchase options may need to be reassessed if the lessee concluded initially that exercise of the purchase option was reasonably certain.

Companies may need to remeasure lease assets and liabilities due to changes in economic incentives to exercise options in their lease contracts.

Getting into more detail

Reassessment of options

IFRS 16 *Leases* requires a lessee to determine whether it is reasonably certain:

- to exercise an option to extend the term of the lease;
- to exercise an option to purchase the underlying asset at the end of the lease; or
- not to exercise an option to terminate the lease early. [Insights 5.1.100.10]

In doing so, lessees consider all relevant facts and circumstances that create an economic incentive for them to exercise an option or not. [IFRS 16.19]

A lessee remeasures its lease liability when a significant event or a significant change in circumstances within its control changes any of its assessments about what is reasonably certain – i.e. to exercise a renewal or purchase option or not to exercise an option to terminate the lease early. [Insights 5.1.330.10]

A lessee applies judgement when identifying significant events or significant changes in circumstances that trigger reassessment of these options. The lessee then considers the effect of current economic incentives to determine whether it is reasonably certain to exercise, or not to exercise, each option.

For example, a retailer concludes that revised commercial plans developed in response to the COVID-19 outbreak trigger a reassessment of renewal options in its store leases. In assessing whether it is reasonably certain to exercise the renewal options, the retailer considers the economic incentives existing at the date of the reassessment.

Accounting for reassessments

If a lessee changes its assessment of whether it is reasonably certain to exercise a renewal or purchase option, or not to exercise an option to terminate the lease early, then it remeasures its lease liability using a revised discount rate. The lessee adjusts the carrying amount of the right-of-use asset for the remeasurement of the lease liability. If the carrying amount of the right-of-use asset is reduced to zero, then any further reductions are recognised in profit or loss. [IFRS 16.39, 40(a)–(b)]

As a result, reassessment can have a significant impact on the carrying amount of lease assets and liabilities at the date of the reassessment. In turn, this may affect the amount and profile of depreciation and interest expense recognised subsequently.

For example, suppose a company that leases a vehicle initially assessed that it was reasonably certain to exercise an option to purchase the vehicle at the end of the lease term. As a result, it included the exercise price of the purchase option in the initial carrying amount of its right-of-use asset and lease liability, and depreciated the right-of-use asset over the useful life of the vehicle. Subsequently, the company concludes that it is not reasonably certain to exercise the purchase option. It therefore remeasures the right-of-use asset and lease liability, and depreciates the right-of-use asset over the lease term.

What about lessors?

Lessees and lessors use the same guidance for assessing whether they are reasonably certain to exercise options on lease commencement. However, unlike lessees, lessors do not generally reassess their initial assessment of the lease term and purchase options.

Changes in the non-cancellable period of a lease

Decisions that companies make during this uncertain time may also affect how the non-cancellable period of a lease is determined. For example, the non-cancellable period of a lease will change if:

- the lessee exercises an option that was not previously included in the measurement of the lease liability;
- the lessee does not exercise an option that was previously included in the measurement of the lease liability;
- an event occurs that requires the lessee to exercise an option that was not previously included in the measurement of the lease liability; or
- an event occurs that contractually prohibits the lessee from exercising an option that was previously included in the measurement of the lease liability. [IFRS 16.21, 40(a)]

IFRS 16 requires a lessee to revise the lease term and remeasure the lease liability using a revised discount rate when there is a change in the non-cancellable period of a lease.

Actions for management to take now

- Consider whether COVID-19-related events and circumstances have triggered a requirement to reassess renewal, termination or purchase options.

- Consider the impact of any changes in economic incentives on whether a company is reasonably certain to exercise, or not to exercise, such options.
- Provide clear and meaningful disclosures about judgements and estimates made in reassessing lease options and lease terms.

9- Insurers: what are the impact for insurers?

What's the issue?

The COVID-19 coronavirus pandemic is affecting insurance companies in many ways. In addition to customer, people and operational considerations, volatile markets have affected investment portfolios. Stock markets have declined in value, bond yields are at record lows and surging credit-default-swap indices are indicating concerns about increased defaults. This may impact insurers' balance sheets and capital ratios significantly.

The implications for insurance liabilities will be mixed depending on the specific types of coverage provided and the accounting policies applied under IFRS 4 *Insurance Contracts*. Insurers should assess the impact on liabilities for reported claims and incurred but not reported claims. They should also assess any knock-on effects for assumptions about reinsurance recoveries, future claims and disclosures.

Insurers should assess possible impairments in investment portfolios and the impact of COVID-19 on their accounting for insurance liabilities, including the liability adequacy test.

Getting into more detail

IFRS 4 applies to insurance and reinsurance contracts and allows the continuation of pre-existing national accounting practices with few additional requirements – e.g. the liability adequacy test based on current estimates of all contractual cash flows. These practices vary widely by country and the specific accounting policies applied will affect the sensitivity of insurance liabilities to current market conditions. On the asset side of the balance sheet, many insurers continue to apply IAS 39 *Financial Instruments: Recognition and Measurement.* [IFRS 4.15–19, 20A–K]

When assessing the impact on insurance liabilities, insurers should consider the coverage provided under the terms and conditions of issued insurance contracts. In a number of countries, regulators and governments are taking specific actions – e.g. grace periods for premium collection, non-cancellation of insurance coverage during the pandemic and waiving co-pays. These actions may impact assumptions about the timing of premium cash flows, the frequency or severity of claims or the continued use of historical trends (e.g. loss ratios) to estimate future claims. Also, stay-at-home regulations and resulting operational challenges may affect the claim settlement process and patterns. For example, claims payments may take more time and could result in a change in the paid-claim patterns used in some actuarial methods for calculating insurance liabilities. However, claims could be paid more quickly in the near term because insurers may face regulatory pressure to 'take care of the policyholder' during the pandemic; they may also forego regular claim adjudication procedures and question fewer claims before paying.

When determining their obligations, insurers need to evaluate the precise extent of coverage and the impact of exclusions and limitations on coverage. This includes an assessment of new directives, laws and regulations that may require insurers to provide coverage or incur claims for events related to COVID-19 in addition to those required by the existing terms and conditions in the insurance contract.

Further, when current demographic and market estimates (including discount rates) are reflected under existing accounting practices, an insurer should assess the extent to which the current developments around COVID-19 require a reassessment of those estimates. As a consequence, an insurer may have to update the demographic and market assumptions used when measuring its insurance liabilities.

Regulation or contractual terms may provide for profit participation by policyholders. Insurers should therefore consider the impact on their obligations, including deferred bonuses and shadow accounting policies.

What is the impact on your type of business?

In general, policyholder behaviour may change because of COVID-19 – e.g. it may affect surrender probabilities and insurance fraud. This may impact the recoverability of deferred acquisition costs (DAC). Measures taken by governments and regulators to slow down the spread of the pandemic may limit sales activity and could impact premium income.

In non-life or general insurance, many policies will have exclusion clauses for pandemic risks, which were strengthened for products such as business interruption and travel insurance after the SARS coronavirus outbreak in 2003. Event cancellation coverage may cause greater losses for insurers because some policies cover pandemic risk. The following types of insurance may also be affected.

- Trade credit insurance – covering businesses against debts that cannot be paid by their customers or suppliers.
- Workers' compensation insurance – workers claiming they were not adequately protected by their employers against exposure to the virus.

Insurers should evaluate the impact on liabilities for reported claims, incurred but not reported claims, future claims liabilities (including claims handling costs) and related assets for reinsurance recoveries.

Reinsurers will need to respond to losses ceded by direct insurers and will need to perform similar evaluations. For some specialised reinsurers, this could have a major impact.

Mortality or morbidity rates from COVID-19 could affect the insurance liabilities for **health insurers**. These insurers should monitor the developments and assess whether they need to revise their assumptions at the reporting date.

Life insurers will probably face the most significant impact. The further decline in interest rates and the downturn in financial markets could lead to impairments of financial assets. Legacy businesses or products that are highly sensitive to market variables are likely to feel the effects more deeply – e.g. variable and fixed annuities, long-term care insurance and universal life insurance. This applies especially to insurance contracts that contain minimum interest rate guarantees. The measurement of the insurance liabilities could be affected directly if these guarantees are measured on a current basis; or indirectly, if a deficit arises in the liability adequacy test that should be recognised in profit or loss.

If information affecting the values of assets and liabilities becomes available after the reporting date, then insurers will need to distinguish between events that provide evidence of conditions that

existed at the reporting date (adjusting events) and those that are indicative of conditions that arose after the reporting date (non-adjusting events). [IAS 10.3, 8, 10]

What is the impact on your investment portfolios under IAS 39?

Insurers need to assess whether impairment losses should be recognised for investments that are not classified as at fair value through profit or loss. Under IAS 39, an investment is impaired if there is objective evidence of a loss event since initial recognition that has an impact on the estimated future cash flows. Indicators of impairment include a borrower's significant financial difficulties or it becoming probable that the borrower will enter bankruptcy or financial reorganisation. A decline in the fair value of a debt instrument or a change in its credit rating may not in itself be an indicator of impairment. However, it may be evidence of impairment when it is considered with other available information. [Insights 7I.6.410.60, 420.10]

For available-for-sale equity investments, IAS 39 requires an impairment loss to be recognised if there has been a significant or prolonged decline in the **fair value** of the investment below its cost. [Insights 7I.6.430.10]

What do you need to disclose?

Annual reports

Insurers should disclose assumptions for, and sensitivities in, the measurement of insurance liabilities. This may involve explaining the impact of COVID-19 risks on your type of insurance business, how experience to date from the COVID-19 outbreak varies from existing assumptions about pandemic risk and how those risks are managed. These disclosures should also include considerations around risk concentrations, claims development tables and credit, liquidity and market risk. [IFRS 4.38–39A, IG41–70]

The COVID-19 situation may increase the level of estimation uncertainty when measuring insurance liabilities. This may require enhanced disclosures and may also affect sensitivity analysis disclosures. [IAS 1.125, IFRS 4.39A]

For investment portfolios, insurers should disclose the nature and extent of risks arising from financial instruments and how they manage those risks. This means that insurers will need to explain the significant impacts of COVID-19 on those risks and how they are managing them. Insurers will need to exercise judgement to determine the specific disclosures that are relevant to their business and necessary to meet these objectives. [IFRS 7.31–42]

Decreases in asset valuations arising from the COVID-19 outbreak may impact regulatory capital and solvency calculations and disclosures about how the entity manages capital. Disclosures may also be required about non-adjusting events occurring after the reporting date that impact subsequent financial asset or insurance liability measurements [IAS 10.21–22, 134–136].

For some insurers, further disclosures around potential **going concern** issues may be required.

Interim reports

IAS 34 *Interim Financial Reporting* does not contain specific disclosure requirements for insurance contracts. However, the general principles apply and the interim financial statements should explain events that are significant to understanding changes in financial position and performance, including changes in estimates, since the last annual financial statements. A company should consider whether the interim report needs to include an update to information disclosed in the last annual financial statements because of the pandemic. [IAS 34.10, 15–16A]

What about other accounting topics for insurers?

For other relevant topics (including IFRS 9 *Financial instruments* implications for insurers that have not applied the temporary exemption), please see our **COVID-19 financial reporting resource centre**.

Actions for management to take now

- Evaluate the specific implications for your company based on the accounting policies applied under IFRS 4 and assess the impact on assumptions for measuring liabilities for reported claims, incurred but not reported claims, future claims and reinsurance recoveries.
- Ensure that your liability adequacy test (including DAC recoverability) is based on current estimates of future cash flows and evaluate whether any deficit should be recognised in profit or loss.
- Evaluate whether a significant or prolonged decline in fair value has arisen for any available-for-sale equity investments.
- Assess whether there is a loss event that has affected the estimated future cash flows of any debt investments and whether to recognise an impairment loss.
- Consider expanding disclosures about pandemic risk management, key demographic and market assumptions, sensitivities in the assumptions, major sources of estimation uncertainty, and liquidity, market and credit risks.
- Consider your capital disclosures, especially where there are concerns about the capital position relative to regulatory requirements or implications for debt covenants.

10- Interim financial statements: what is the impact of COVID-19?**New**

What's the issue?

For calendar year end companies, the 2020 interim reporting period will be the first reporting period when the impacts of the COVID-19 coronavirus outbreak are reflected in the financial statements – i.e. it *will affect* the measurement and recognition of assets and liabilities, income and expenses.

IAS 34 *Interim Financial Reporting* generally requires that all events and transactions are recognised and measured as if the interim period were a discrete stand-alone period – i.e. there are generally no recognition or measurement exemptions for interim financial reporting. [Insights 5.9.80.10]

Condensed interim financial statements (hereafter referred to as 'interim financial statements') typically focus on changes since the last annual financial statements. Companies are required to provide an explanation of events and transactions that are significant to an understanding of the changes in their financial position and performance since the last annual reporting date. Information disclosed in relation to those events and transactions updates the relevant information presented in the most recent annual financial report. Given the rapidly changing economic outlook and trading conditions, information in 2020 interim financial statements may, for many companies, comprise *more than the usual update* since the last annual financial statements. [IAS 34.15]

If changes in circumstances have made significant disclosures in the last annual financial statements less relevant, then a company needs to consider providing additional supplementary disclosures in its interim financial statements. [Insights 5.9.30.10]

Although many disclosures required by other IFRS® Standards are not mandatory in interim financial statements, in the current circumstances companies may need to provide these disclosures to ensure that the interim financial statements provide relevant information to the users of those statements.

Preparing 2020 interim financial statements is likely to involve more than the usual update since the last annual financial statements. Investors and other users may expect information above and beyond what is typically disclosed.

Getting into more detail

Our **COVID-19 financial reporting resource centre** provides guidance on a broad range of topics covering the financial reporting impacts of the COVID-19 outbreak and is relevant to both annual and interim financial statements.

Recognition, measurement and disclosure in interim financial statements

Generally, items are required to be recognised and measured as if the interim period were a discrete stand-alone period. However, there are specific requirements for income taxes. [Insights 5.9.80.10]

We address below some of the key areas that companies may need to consider when preparing their 2020 interim financial statements. Whether they are relevant depends on the company's specific circumstances – i.e. the nature and extent of COVID-19 impacts on the financial position, performance and cash flows of the company.

Going concern

Management's **going concern assessment** may be significantly affected by the current circumstances.

The considerations that apply for the going concern assessment when preparing annual financial statements also apply for interim financial statements. When assessing the uncertainties associated with a company's going concern assumption, management takes into account all available information for a period of at least 12 months from the date of the interim financial statements. For example, when a company with a calendar year end prepares its quarterly interim financial statements at 31 March 2020, it considers information for the period until, but not limited to, 31 March 2021 when assessing whether the going concern assumption is appropriate. [Insights 5.9.10.30, 35]

If there is a material uncertainty about the company's ability to continue as a going concern at the date on which the interim financial statements are authorised for issue, then that uncertainty is disclosed in those interim financial statements. This is the case irrespective of whether it was disclosed in the most recent annual financial statements. In addition, disclosure is required when management concludes that there are no material uncertainties but reaching that conclusion involved significant judgement (a 'close call'). [Insights 1.2.80, 5.9.10.38]

Impairment of non-financial assets

Reviews for indicators of impairment and any resulting tests for **impairment of non-financial assets** are performed at the interim reporting date in the same manner as at the annual reporting date. [Insights 5.9.200.10]

Companies may have tested their goodwill and intangible assets[1] for impairment under IAS 36 *Impairment of Assets* when preparing their latest annual financial statements. However, given the current economic circumstances, there may well be indicators of impairment at the interim reporting date that trigger testing of these assets again for impairment.

If a company recognises a material impairment loss on non-financial assets, then it provides in its interim financial statements an explanation of and an update to the relevant information included in the last annual financial statements. IAS 36 provides relevant disclosures to be considered in this regard. [IAS 34.15B(b), 15C]

Property, plant and equipment (PPE) and intangible assets

Companies are required to review the residual value and the useful life of an asset at least at each financial year end. [IAS 16.51]

Given the current economic conditions, companies need to reassess those estimates during the interim period if the usage or retention strategy for these assets has changed. [IAS 16.51, 38.104]

Impairment of financial assets

Companies apply the same criteria when testing for **impairment of financial assets** as those at its annual reporting date.

If a company recognises a material impairment loss on financial assets, then it provides in its interim financial statements an explanation of and an update to the relevant information included in the last annual financial statements. IFRS 7 *Financial Instruments: Disclosures* provides relevant disclosures to be considered in this regard. [IAS 34.15B(b), 15C]

Fair value measurement

The carrying amount of assets that are measured at **fair value** – e.g. investment property – is determined at the interim reporting date.

Performing a valuation that uses significant unobservable inputs becomes more challenging in the current environment and, given the current market volatility, extrapolations based on the balance at the previous annual reporting date may not be appropriate.

Companies may need to consider using external valuers to determine the fair value of assets for which quoted prices are not available. This includes determining the fair value of non-financial assets – e.g. PPE and right-of-use assets that are valued using the revaluation model, and investment properties.

The specific disclosures required by IAS 34 for fair value measurement need to be provided.

Impact on employee benefits and employer obligations

Remeasurement of net defined benefit obligations/assets: Companies preparing interim financial statements should consider whether net **defined benefit obligations/assets** need to be remeasured. Under IAS 19 *Employee Benefits,* remeasurements are recognised in the period when they arise; therefore, if adjustments at the interim reporting date are considered to be material, then they need to be recorded at that date.

Actuarial valuations: An updated measurement of plan assets and obligations is required when a plan amendment, curtailment or settlement is recognised. In addition, significant market fluctuations may trigger the need for an updated actuarial valuation. [IAS 34.IE.B9, Insights 4.4.360, 5.9.150]

Inventories

Net realisable value: IAS 2 *Inventories* requires a company to measure its inventory at the lower of cost or net realisable value and update its estimate of the **net realisable value** at the interim reporting date. The COVID-19 outbreak may affect this estimate. [IAS 34.IE.B25]

Write-down losses: If a company writes inventory down to its net realisable value at the

interim reporting date, then any resulting losses need to be recognised immediately – i.e. they cannot be deferred because they are expected to be restored or absorbed by the annual reporting date. [Insights 5.9.90]

Companies need to disclose the write-down of inventories to net realisable value and their reversal. [IAS 34.15B(a)]

Income taxes

Effective tax rate: Under IAS 34, the income tax expense recognised in each interim period is based on the best estimate of the weighted-average annual income tax rate expected for the full year applied to the pre-tax income for the interim period.

The unprecedented challenges caused by the COVID-19 outbreak may cause companies to conclude that they cannot estimate their annual effective tax rate reliably. In this case, the actual effective rate, based on a year-to-date actual tax calculation, may represent the best estimate of the annual effective tax rate. [IAS 34.30(c), Insights 5.9.160.80]

Tax reliefs: In response to the COVID-19 outbreak, governments may introduce tax reliefs for certain types of income, additional tax deductions, a reduced tax rate or an extended period to use tax losses carried forward. Companies recognise tax credits that relate to a one-off event in the interim period in which the event occurs, rather than reflect them in their estimate of the annual effective tax rate. Conversely, a change in the tax rate that is substantively enacted in an interim period may be recognised as a one-off event or spread over the remainder of the annual reporting period via an adjustment to the estimated annual effective tax rate. [IAS 34.IE.B19, Insights 5.9.160.30–35]

Recoverability of deferred tax assets: A deferred tax asset is recognised for deductible temporary differences and unused tax losses (tax credits) carried forward, to the extent that it is probable that future taxable profits will be available. The COVID-19 outbreak may affect a company's projections of the probability of future taxable profits, which in turn could affect the recognition of **deferred tax assets** at the interim reporting date.

Subsequent events

Date of authorisation: In the current market conditions, companies should consider disclosing the date on which the interim financial statements are authorised for issue and who gave that authorisation. This is not specifically required by IAS 34 but it may help users' understanding because any event that occurs after that date is not disclosed or adjusted for in those interim financial statements. [IAS 10.17–18]

Adjusting vs non-adjusting: A company discloses events that occurred after the interim reporting date but are not reflected in the interim financial statements. Determining those **subsequent events** that should be reflected (adjusting) vs those that are disclosed (non-adjusting) in the interim financial statements may require judgement. [IAS 34.16A(h)]

Unusual items

A company discloses the nature and amount of items affecting assets, liabilities, equity, net income or cash flows that are unusual because of their nature, size or incidence. [IAS 34.16A(c), Insights 4.1.100]

Current/non-current classification

Companies should consider the classification of assets and liabilities as **current or non-current** at the interim reporting date. For example, a loan for which provisions are breached at the interim reporting date, such that the liability becomes repayable on demand, would need to be classified as current, unless the company obtained a waiver before the interim reporting date.

Companies need to disclose any loan default or breach of a loan agreement that has not been remedied on or before the interim reporting date. [IAS 34.15B(i)]

Additional line items

Interim financial statements generally include the headings and subtotals that were included in the most recent annual financial statements. However, given the current circumstances, companies may consider presenting additional line items if they deem them to be useful for users – e.g. presentation of government grants. [IAS 34.10]

Disclosures

In the current market conditions, companies should ensure that the minimum disclosure requirements of IAS 34 are supplemented by additional disclosures, if they are relevant to an understanding of their interim results, position and cash flows, including:

- changes in significant judgements and assumptions made by management, as well as areas of estimation uncertainty as required by IAS 1; and
- overarching disclosures of the impact of the COVID-19 outbreak on the interim financial position, performance and cash flows. [IAS 34.15, 15B(d), 15C, IAS 1.17(b)–(c), 122, 125]

IAS 34 contains other specific disclosure requirements for financial assets and/or financial liabilities. [IAS 34.15B(h), (k), (l), 16A(j)]

Some regulators[2] have emphasised that, given the magnitude of the latest economic changes, companies should provide in their interim financial statements sufficient disclosure for investors to understand the significant events and transactions that have occurred since the annual financial reporting date. [IAS 34.15B, 16A]

Companies need to consider whether their 2020 interim financial statements provide sufficient information because investors and other users may expect information above and beyond what is typically disclosed. Condensing or omitting disclosures on the assumption that users have access to the most recent annual financial statements may no longer be appropriate – i.e. information disclosed in the 2019 annual financial statements may be less relevant in the current circumstances.

Actions for management to take now

- Assess the company's ability to continue as a going concern at the interim reporting date.
- Consider whether information disclosed in the last annual financial statements remains relevant. If not, then provide updated disclosures.
- Assess and reflect the impacts of the COVID-19 outbreak in the interim financial statements – in particular, whether uncertainties are factored into all the necessary estimates and judgements.
- Assess whether the disclosures and explanations provided in the interim financial statements are sufficient for users to understand the significant events and transactions that have occurred since the annual reporting date.
- Provide additional disclosures to enable users of interim financial statements to understand the overall impact of the COVID-19 outbreak on the financial position and performance of the company.

[1] Intangible assets with an indefinite useful life or intangible assets that are not yet available for use.

[2] ESMA statement issued on 25 March, **Accounting implications of the COVID-19 outbreak on the calculation of expected credit losses**.

11- How should companies assess COVID-19 events after the reporting date? New

What's the issue?

The COVID-19 coronavirus pandemic has evolved rapidly in 2020 and it impacts how companies evaluate and disclose events after the reporting date ('subsequent events'). Depending on a company's reporting date, the impacts of the COVID-19 outbreak could be adjusting or non-adjusting events.

Under IAS 10 *Events After the Reporting Period*, events, both favourable and unfavourable, that occur between the reporting date and the date when the financial statements are authorised for issue require disclosure or possibly affect recognition and measurement in the financial statements. [Insights 2.9.20.30]

IAS 10 identifies two types of events.

Events after the reporting date	Definition	Financial statement effects
Adjusting events	Those that provide evidence of conditions that existed at the reporting date	Adjust the amounts recognised in the financial statements
Non-adjusting events	Those that are indicative of conditions that arose after the reporting date	Disclose the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made

Therefore, companies need to evaluate all events that occurred after their reporting date and assess:

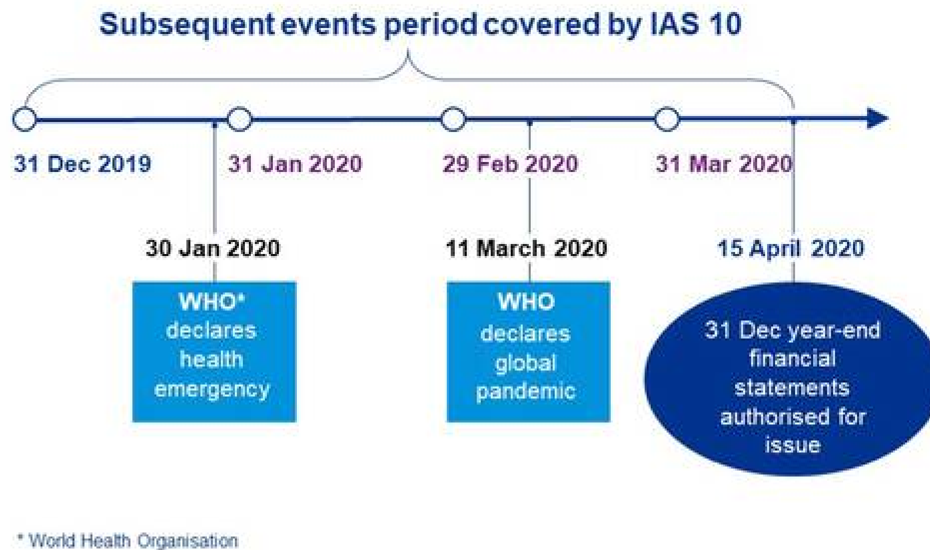
- which of those events provide additional evidence of conditions that existed at the reporting date and for which financial statements need to be adjusted; vs
- which lead to disclosure only.

Companies need to exercise significant judgement in determining which events after the reporting date are adjusting events.

KPMG

Getting into more detail

Considerations for assessing events after the reporting period



Impact at reporting date(s)

31 December 2019 and 31 January 2020

For 31 December 2019 financial statements, the financial reporting effects of the COVID-19 outbreak are generally **non-adjusting events** (with the exception of going concern) because the significant changes in business activities and economic conditions occurred as a result of events arising after the reporting date – e.g. actions taken by governments and the private sector to respond to the COVID-19 outbreak.

Certain events did occur before 31 December 2019 – e.g. the Wuhan Municipal Health Committee issued an urgent notice about the virus on 30 December 2019 and cases were reported to WHO on 31 December 2019. However, the announcement by WHO that the coronavirus was a global health emergency was made on 30 January 2020 – i.e. after the end of a 31 December reporting period – and measures taken by many national governments followed this announcement. Many actions taken by governments and the private sector to respond to the outbreak also followed after 31 December 2019. Therefore, based on information about the outbreak that was reasonably available as at 31 December 2019, it is likely that market participants would have made either no adjustments to their assumptions, or only inconsequential changes, based on their assessments of the available information and associated risks as at that date.

The effects of the COVID-19 outbreak did not have a significant impact on global markets and share prices until after 31 January 2020. Accordingly, concluding that developments after 31 January 2020 provide more information about the circumstances that existed at 31 January reporting dates – and are therefore considered adjusting events under IAS 10 – will be challenging unless the COVID-19 outbreak had a significant impact on the company as at

31 January (e.g. the company had significant operations in China). If management determines that developments after 31 January 2020 are adjusting events, then this will probably be a significant judgement that would require clear disclosure, including the reasons why management concluded that these developments are adjusting events.

Subsequent periods – Including 29 February and 31 March 2020

For companies with reporting periods ending in February or March 2020, and calendar year end companies reporting in the first quarter of 2020, the COVID-19 outbreak is likely to be a current-period event that will require ongoing evaluation to determine the extent to which developments after the respective reporting date should be recognised in that reporting period.

As the impacts of the COVID-19 outbreak continue to evolve, capturing events that relate specifically to conditions that existed at or before the reporting date – i.e. adjusting events – will require careful assessment. To do that, companies need to carefully assess their specific facts and circumstances to identify events that generally represent the culmination of a series of conditions that existed at or before the reporting date.

Disclosures

For material non-adjusting events, companies are required to disclose the nature of the event and an estimate of its financial effect, or a statement that an estimate cannot be made. A non-adjusting event is considered material if it is of such importance that non-disclosure would affect the ability of the financial statements' users to make proper evaluations and decisions. [Insights 2.9.30.30]

As the date of authorisation moves further from the reporting date, users might expect that a company would have more information available to disclose an estimate of the financial effects of a non-adjusting event.

Actions for management to take now

When assessing the impact of COVID-19 events after the reporting date, management needs to do the following.

- Identify and consider all subsequent events until the date the financial statements are authorised for issue and determine whether these events are adjusting – i.e. they provide evidence of conditions that existed as at the reporting date or indicate that the **going concern** assumption is inappropriate.
- Disclose the nature and financial effects of events that are considered to be material, even if they are non-adjusting.