IFRS in Focus
Closing Out 2020

Contents

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Regardless of industry, financial condition, supply chain and distribution logistics, workforce composition, changing customer preferences, etc., all entities face a myriad of financial reporting and accounting challenges related to COVID-19, albeit the nature and degree of those challenges will vary.

In this special edition of *IFRS in Focus* Closing Out 2020, we discuss some of these challenges and also set out other financial reporting issues that may be relevant for years ending on or after 31 December 2020 as a result of regulatory focus, the current economic environment or changes in accounting standards. Where relevant, we indicate where further information can be found. In particular, our publication *IFRS in Focus* 'Accounting considerations related to the Coronavirus 2019 Disease' is continually updated and provides detailed analysis of the key IFRS considerations related to conditions that may result from the pandemic.

The recurring theme in this *Closing Out* publication is the need for transparency in financial reporting in times of high uncertainty. This is a key message that has been conveyed by regulators worldwide.

In its 29 May 2020 statement, the International Organization of Securities Commissions, IOSCO, acknowledged the difficulties entities face in preparing financial statements in an evolving and uncertain environment, with potentially imperfect information that could change after financial information is made publicly available. It noted that in such an environment of heightened uncertainty, it is important that financial reporting includes disclosures that provide an adequate level of transparency and are entity-specific and clear judgements and estimates made. Disclosures should explain the material impact on specific assets, liabilities, liquidity, solvency and going concern issues as relevant and any significant uncertainties, assumptions, sensitivities, underlying drivers of results, strategies, risks and future prospects.

This message continues to be of the utmost importance. Indeed, it is particularly important to provide users of the financial statements with appropriate insight into the entity's resilience in the face of the current uncertainty and to understand the key assumptions and judgements made when preparing financial information.

Judgements and estimates

The uncertainties brought by the pandemic are likely to have broadened the range of reasonably possible assumptions that management is required to make about the future in preparing financial statements.

The macroeconomic impact of the pandemic, the timing and shape of recovery, the availability of fiscal/financial support and the ultimate effects on future operating results and cash flows make reliable point estimates challenging. Entities will often need to use different scenarios as part of their forecasting process (for example as part of the impairment tests required by IAS 36 *Impairment of Assets*). The weighting of the different scenarios to develop an expected value needs to be calibrated based on reasonable, supportable and realistic estimates and assumptions, in order to avoid the risk of an overly optimistic or pessimistic bias.

To enable users to understand the impact of uncertainty on the reported numbers, it will be critical that management provides sufficiently detailed disclosure of significant judgements and key sources of estimation uncertainty as required by IAS 1 *Presentation of Financial Statements*.

Entities must provide a quantification of estimation uncertainty and disclose the assigned values for key inputs and assumptions. In many cases, this will require information about the sensitivity of carrying amounts to the methods, assumptions and estimates underlying management's calculation as noted in IAS 1:129.

In identifying areas for which disclosure of significant judgements and major sources of estimation uncertainty is required, entities need to take into account items relating to their business model, financial position, performance and cash flows which have raised particular concerns or discussions in the management, administrative or supervisory bodies, including the audit committee, and with the external auditors. These disclosures are particularly important as entities with similar circumstances may have different judgements and estimates based on the information available. Entities should also ensure consistency with major risks disclosed in other areas of the financial statements and the annual financial report, as well as reflecting consistency with areas identified as key audit matters.

Entities will need to consider all available information in that process and must make sure that estimates, assumptions and judgements are consistent with each other.

A Deloitte *IFRS in Focus* 'Accounting considerations related to the Coronavirus 2019 Disease' as well as a video in our COVID-19 video series provide more detail regarding the requirements on disclosures of significant judgements and estimates, matters to consider in determining what to disclose and the potential effects of COVID-19 on judgements and estimates.

Going concern

The potential prolonged disruption caused by COVID-19 may raise concerns about whether an entity is able to continue as a going concern for at least 12 months from the date the financial statements are authorised for issue, taking into account all the information available up to that date. Entities will need to consider the following factors, among others:

- Changes in forecast results
- Potential liquidity and working capital shortfalls
- Ability to access capital
- Contractual obligations
- Diminished demand for products and services
- Disruption to supply chains
- Over-reliance on temporary public support measures

In addition, management must consider whether its plans, including potential government assistance, are able to mitigate the negative impacts on its business.

While the effects of COVID-19 may be greater in certain industries (e.g. airlines, travel, hospitality), the current economic environment has significantly strained the ability of a number of entities to develop and maintain sustainable business models. When management is aware of material uncertainties that cast a significant doubt on the entity's ability to continue as a going concern, IAS 1:25 requires the entity to disclose those material uncertainties in the financial statements. The disclosure should be specific to an entity's own situation, for example explaining how and when the uncertainty may crystallise and its impact on the entity's resources, operations, liquidity and solvency. The assumptions used in determining whether an entity is a going concern must be consistent with the information used in other areas of the financial statements (e.g. liquidity risk management disclosure, impairment of non-financial assets, recognition of deferred tax assets, hedge accounting).

In the current environment, reaching the conclusion that there are no material uncertainties that cast substantial doubt on the entity's ability to continue as a going concern may involve significant judgements on the range of outcomes to consider and the probabilities assigned to those outcomes. In the July 2014 IFRIC Update, the IFRS Interpretations Committee concluded that disclosure of significant judgements is required when an entity concludes there is no material uncertainty regarding its ability to continue as a going concern but reaching this conclusion involved significant judgement.

A Deloitte *IFRS in Focus* 'Accounting considerations related to the Coronavirus 2019 Disease' as well as a video in our COVID-19 video series provide more detail on key considerations in assessing an entity's ability to continue as a going concern and highlights what information in that respect may be relevant to users of the financial statements.

Presentation of COVID-19-related items in the statement of profit or loss

Whilst the current environment may be unprecedented, it results from a series of events globally that are likely to have a wide range of potentially long-term consequences. Some of the impacts will give rise to discrete losses or expenses, such as those related to impairment losses or restructuring plans. However, there may also be other impacts such as an overall decrease in entities' profitability due to lower revenue and/or the continuance of salaries and other expenses while operations are closed or curtailed.

Accordingly, the identification and quantification of the impacts of COVID-19 on an entity's performance may be difficult without the use of arbitrary assumptions or allocations. Further, it would not be appropriate to present results in IFRS financial statements as though the impacts of COVID-19 had not happened on the grounds that the issue was not present in the comparative period. For these reasons, it will generally be more appropriate to include information that entities seek to provide to explain the impact of COVID-19 in the notes to financial statements or other financial communications.

Many of the impacts of COVID-19 on an entity are likely to form part of the entity's normal activities and thus should be considered to form part of the underlying business performance. IAS 1:45 requires that the presentation of items in the financial statements must be retained from one period to the next. It would therefore not be compliant with this requirement to exclude COVID-19-related items from 'underlying' results presented in the statement of profit or loss.

Regulators encourage entities to disclose qualitative and quantitative information on the significant impacts of COVID-19 and the methodology applied for their determination, in a way that provides a clear and unbiased picture of the multiple areas affected by COVID-19. Entities could consider providing such disclosures in a single note or, if the impacts are explained in multiple notes, provide clear cross-referencing amongst the relevant notes.

A Deloitte *IFRS in Focus* 'Accounting considerations related to the Coronavirus 2019 Disease' as well as a video in our COVID-19 video series provide more detail on factors an entity should consider in determining how to present the effect of COVID-19 in the profit or loss statement.

'Non-GAAP' or alternative performance measures

The use of 'non-GAAP' or alternative performance measures (APMs) has been an area of regulatory concern in many jurisdictions around the world for some time, with IOSCO publishing a Final Statement on Non-GAAP Financial Measures in 2016.

In its 29 May 2020 Statement on Importance of Disclosure about COVID-19, IOSCO notes "[g]iven the uncertainty in the current environment, issuers should carefully evaluate the appropriateness of an adjustment or alternative profit measure. Not all COVID-19 effects are non-recurring and there may be a limited basis for management to conclude that a loss or expense is non-recurring, infrequent or unusual… It could be misleading to describe an adjustment as COVID-19 related, if management does not explain how an adjusted amount was specifically associated with COVID-19. For example, we caution issuers from characterizing an impairment as COVID-19 related, where indicators of impairment existed prior to the pandemic that are unrelated to COVID-19. Additionally, characterizing hypothetical sales and/or profit measures (e.g., had it not been for the effect of COVID-19 the company's sales and/or profits would have increased by XX%) as non-GAAP financial measures would not be appropriate."

The Deloitte publication Alternative performance measures: A practical guide provides guidance on the use of APMs. It sets out what is considered best practice and provides real-life examples of how entities present such measures. It covers requirements as issued by IOSCO and the European Securities and Markets Authority (ESMA), but entities should also consider any further requirements in their local jurisdictions.

In addition, a Deloitte *IFRS in Focus* 'Accounting considerations related to the Coronavirus 2019 Disease' provides more detail on what an entity should consider before publishing new or revised APMs to present the impact of COVID-19.

Liquidity risk management

In these uncertain times when access to financing may prove more difficult than usual, regulators highlight the importance of providing clear information on an entity's liquidity position, as required by IFRS 7 *Financial Instruments: Disclosures*.

The pandemic may have given rise to new significant financial risks that did not exist before or which were not as significant. Events and transactions that might reveal liquidity risk include, for example, new significant amounts of debt, debt renegotiations, new financial arrangements or the breach of debt covenants.

Classification of liabilities as current or non-current when a breach of covenant occurs

If a covenant breach occurs on, or before, the reporting date and the breach provides the lender with the right to demand repayment within 12 months of the reporting date, the liability should be classified as current in the entity's financial statements in the absence of any agreements made on or prior to the reporting date that give the entity a right to defer payment beyond 12 months after the reporting date. A waiver of a covenant breach after the reporting date should be disclosed as a non-adjusting event but does not affect the classification of the liability at the reporting date.

Entities may look for ways to manage their liquidity risk, including the use of alternative sources of funding, such as delayed payment to suppliers and arrangements with financial institutions such as supplier financing and reverse factoring which may permit the entity to draw down on financing in exchange for the financial institution paying the entity's suppliers. Disclosure of these facilities will be critical particularly when they are material to the entity's funding or viability (see the section on 'Supplier financing arrangements' for more details).

Also, entities that have benefitted from government grants and assistance, forbearance or payment moratoria measures should disclose this fact along with the features of any such measures to enable users to understand any risks that may stem from their discontinuation.

Other impacts that may require disclosure include delays in capital project plans, cost reduction programmes or changes in the entity's dividend policy.

A Deloitte *IFRS in Focus* 'Accounting considerations related to the Coronavirus 2019 Disease' provides more detail on factors to consider when identifying what information should be disclosed with respect to liquidity risk management.

Expected credit losses

COVID-19 can affect the ability of borrowers, whether corporate or individuals, to repay amounts owed. Individual and corporate borrowers may have a particular exposure to the economic impacts in their geography and industry sector. Reductions in forecasts of economic growth increase the probability of default across many borrowers. More broadly, a decline in asset prices means a decline in the value of the underlying collateral, which then may lead to increased loss rates.

The impact of COVID-19 on expected credit losses (or ECL) will be particularly challenging and significant for banks and other lending businesses. However, the effect could also be significant for non-financial corporates. This is because ECL applies not only to loans to third parties, but also to many investments in interest-bearing financial assets (for example, bonds and debentures) as well as to trade receivables, loans to joint ventures and associates, contract assets, lease receivables, issued loan commitments and financial guarantee contracts. In individual entity financial statements it also applies to intra-group transactions such as intra-group loans or guarantees provided by the reporting entity on other entities' debt obligations.

The staging analysis in IFRS 9 *Financial Instruments* requires the estimate of lifetime probability of default at initial recognition of a financial asset and at each reporting date thereafter, based on an assessment of forward-looking information, which is particularly challenging given uncertainties regarding the impact of COVID-19. Despite the challenges, entities are required to make estimates that reflect in an unbiased way the significant uncertainty that characterises the current economic environment by taking into account all reasonable and supportable information about past events, current conditions and forecasts of future economic conditions that is available without undue cost or effort at the reporting date.

A Deloitte *IFRS in Focus* 'Accounting considerations related to the Coronavirus 2019 Disease' as well as a video in our COVID-19 video series provide more detail on how COVID-19 can affect expected credit losses.

Another Deloitte *IFRS in Focus* discusses certain key IFRS accounting considerations related to the accounting for ECL that may result from the COVID-19 pandemic. The focus of this publication is for lenders and banks though much of it will be applicable to measurement of ECL in industries other than financial services.

In addition, a Deloitte *A Closer Look* publication explains how the ECL model is applied to trade receivables and another Deloitte *A Closer Look* publication provides more detail on measuring expected credit losses for intercompany loan assets with no documented contractual terms.

Impairment reviews

The disruptions to the economic environment caused by the COVID-19 pandemic will put impairment reviews in the spotlight. Regulators expect that for many entities the adverse impact of COVID-19 will constitute a strong indication that one or more impairment indicators in IAS 36 have been triggered and that an impairment test is required. This is the case even if a test was performed at an interim reporting period.

Regulators also note that, while the outlook on the future economic conditions remains uncertain, entities are expected to update any assumptions used in previous interim periods to reflect the latest available information. They recommend that entities disclose how the assumptions and measurements have changed, if at all, compared to the last annual and interim reporting.

A clear disclosure of sensitivity analyses is crucial, including when there has been a previous impairment. Sensitivity analyses must provide all the information required by IAS 36:134(f) and 135(e) (e.g. values assigned to key assumptions and headroom), as well as the information required by IAS 1 (see section 'Judgements and estimates'). To indicate how 'close' an asset is to being impaired, entities should provide the amount by which the values assigned to the key assumptions would have to change in order for the recoverable amounts of the assets to be equal to their carrying amounts. If an entity believes that no reasonable change to assumptions would result in impairment, entities should indicate what is considered a "reasonable change". In addition to the typical changes in assumptions, entities should consider disclosing how sensitive the carrying amounts of assets are to a delay in the expected date of a return to pre-pandemic cash flow levels.

A Deloitte *IFRS in Focus* 'Accounting considerations related to the Coronavirus 2019 Disease' as well as a video in our COVID-19 video series provide more detail on how COVID-19 can affect impairment reviews. This includes, among other things, a discussion of factors to consider in estimating future cash flows and a reminder of the disclosure requirements.

IFRS 16 *Leases*

In the wake of COVID-19, many entities have made, or are in the process of making, changes to various lease terms (e.g., timing of payments, amount of payments, and duration of agreements). In addition, the IASB has amended the leasing Standard to provide relief to lessees when accounting for rent concessions resulting from COVID-19.

Lessees and lessors will need to provide clear disclosures on the accounting policy applied when accounting for any relief measures granted or received. In addition, specific disclosures are required if a lessee takes advantage of the relief provided in the recent amendment to IFRS 16.

Lessors which have granted rent concessions should provide adequate disclosures reflecting the risks that the current market conditions may result in significant changes in the assets subject to operating lease agreements.

Any significant changes in judgements as a consequence of COVID-19 (for example with regard to lease term) must be clearly communicated. Estimation uncertainty when testing for impairment of right of use assets must be explained and quantified.

The disclosure of additional information that a lessee should provide on the effect of leases on their financial statements (see IFRS 16:B48) may complement the information already available to users of financial statements on the impact of the pandemic on an entity's financial position, performance and cash flows. Such information is likely to be relevant to users of financial statements if it helps them to understand (i) the flexibility provided or particular restrictions imposed by lease contracts, (ii) the sensitivity of reported information to key variables, and (iii) the exposure to other risks arising from leases including, for example, liquidity risks, deviations from industry practice, unusual or unique lease terms and conditions that affect a lessee's lease portfolio.

A Deloitte *IFRS in Focus* 'Accounting considerations related to the Coronavirus 2019 Disease' as well as a video in our COVID-19 video series provide more detail on how the consequences of COVID-19 can affect lessees and lessors, in particular with respect to accounting for lease concessions.

In respect of COVID-19 and more generally, clear and comprehensive disclosure is necessary to provide clarity on the effects of leasing on an entity's financial performance and position.

In 2019, entities adopted IFRS 16 in their financial statements for the first time. Some regulators have observed that there is room for improvement and refinement in the disclosures provided. We highlight some of their key findings below.

Judgements
The material accounting judgements with regard to lease contracts must be sufficiently described. In particular, judgements over whether a contract contains a lease and, if so, the term of that lease must be specific to the entity.

Accounting policies
Accounting policies disclosed must be specific to an entity's circumstances. Accounting policies are less helpful if they include boilerplate language and do not address apparently material items.

Quantitative disclosures
Lessees must disclose the information required by IFRS 16:53 in relation to expenses and depreciation charges which affect the statement of profit or loss for the reporting period, including separately disclosing those relating to variable lease payments not included in the measurement of lease liabilities and those stemming from exemptions in IFRS 16 (e.g. short-term or low-value asset leases).

The disclosures required by IFRS 16:53 must be presented in a tabular format, unless another format is appropriate. Not using this tabular format or appropriate cross references makes it difficult for users to find the information. Exposures to future cash outflows must be well explained, for example when there are unrecognised lease extension options or variable lease payments.

The maturity analysis of lease liabilities required by IFRS 16:58 should be disclosed separately from other financial liabilities with appropriate time bands.

IFRS 15 *Revenue from Contracts with Customers*
Business disruptions associated with COVID-19 may prevent an entity from entering into customer agreements under its normal business practices, which may make the determination of whether the entity has enforceable rights and obligations challenging.

In addition, because some of the entity's customers may be experiencing financial difficulties and liquidity issues, an entity may need to develop additional procedures to properly assess the collectability of its customer arrangements and consider changes in estimates related to variable consideration (for example because of greater returns, reduced usage of its products or services, or decreased royalties).

To help its customers or to provide incentives for them to continue purchasing its goods or services, an entity may revise its agreements to reduce any purchase commitments, to allow customers to terminate agreements without penalty or provide price concessions, discounts on future purchases, free goods or services, extended payment terms or extensions of loyalty programmes.

Further, because the entity itself may be experiencing financial difficulties and supply disruptions, it may take steps such as requesting up-front payments from its customers or delaying the delivery of goods. It may also pay penalties or provide refunds for failing to perform, not meeting service-level agreements, or terminating agreements. Furthermore, it may incur unexpected costs to fulfil its performance obligations.

Entities should carefully assess whether their revenue recognition policies are affected by these or other situations that arise as a result of the COVID 19-pandemic.

A Deloitte *IFRS in Focus* 'Accounting considerations related to the Coronavirus 2019 Disease' provides more detail on how COVID-19 can affect an entity's revenue recognition policies.

Although they note some progress, some regulators continue to identify room for improvement in the disclosures entities provide with respect to revenue from contracts with customers. They note that entities should review critically their revenue-related disclosures to ensure they provide a clear understanding of how they have applied the requirements of the Standard to their own particular circumstances, in particular on the following issues.

Disaggregation of revenue
The disaggregation of revenue should reflect the risks to which the nature, amount and timing of revenue are most sensitive.

Timing of revenue recognition
Entities must disclose when their performance obligations are satisfied and thus revenue is recognised. If performance obligations are satisfied over time, entities must explain the reasons why. The method used to measure progress of 'over time' revenue recognition must also be explained. If performance obligations are satisfied at a point in time, entities must sufficiently explain at which time performance obligations are satisfied.

Variable consideration
The nature and estimation technique for variable consideration must be disclosed, including how it is constrained. The related risks must be clearly articulated and must not be misleading. When estimation uncertainties indicate a significant risk of a downward adjustment to revenue, entities must ensure that the variable consideration constraint has been appropriately applied.

Costs to obtain or fulfil a contract
When relevant for the activities of the entity, the accounting policy and quantifications for costs to obtain or fulfil a contract must be disclosed.

Significant judgements
Specific judgements with regard to revenue recognition must be disclosed. This applies particularly to judgements made in determining that an entity was acting as a principal rather than an agent as well as judgements made in determining whether multi-element arrangements contained a single performance obligation or a number of performance obligations. Quantitative disclosures, such as sensitivity analyses or the range of potential outcomes must be provided for judgements involving estimation uncertainty.

A Deloitte *A Closer Look* publication provides more detail on evaluating whether an entity is acting as a principal or an agent.

Contract balances
Entities must disclose how contract assets and liabilities arise and how they vary year-on-year. The relationship between the fulfilment of performance obligations and the timing of cash flows should be clearly explained.

Contract modifications
When there have been contract modifications, the accounting for such events must be clear from the accounting policies.

Information on an entity's financing activities

Supplier financing arrangements

Supplier financing arrangements (also referred to as 'reverse factoring') are often designed to benefit both the buyer and the supplier liquidity. In some jurisdictions, they have become common in response to public policy initiatives that encourage prompt payment to suppliers.

The terms of supplier financing arrangements vary, but typically involve suppliers being paid in line with, or in advance of, invoice terms by a third-party financial institution who is then reimbursed by the purchaser at a later date, which may be in line with invoice terms or later.

The IFRS Interpretations Committee (Committee) discussed supplier financing issues in its June 2020 meeting and published a tentative agenda decision.

The Committee discussed how an entity should present liabilities to pay for goods or services received when the related invoices are part of a reverse factoring arrangement. The Committee concluded that these are a trade payable only when the liability:

- represents a liability to pay for goods or services;
- is invoiced or formally agreed with the supplier; and
- is part of the working capital used in the entity's normal operating cycle.

On the question of whether these liabilities should be presented separately, the Committee concluded that, applying IAS 1, an entity presents:

- Other payables together with trade payables only when those other payables have a similar nature and function to trade payables, for example when other payables are part of the working capital used in the entity's normal operating cycle.
- Liabilities that are part of a reverse factoring arrangement separately when the size, nature or function of those liabilities makes separate presentation relevant to an understanding of the entity's financial position. In assessing whether to present such liabilities separately (including whether to disaggregate trade and other payables), an entity considers the amounts, nature and timing of those liabilities (IAS 1:55 & 58).

The Committee observed that for derecognition of liabilities that are or become part of a reverse factoring arrangement, IFRS 9 applies. For the presentation in the cash flow statement, the Committee observed that an entity's assessment of the nature of the liabilities that are part of the arrangement (see above) may help in determining the nature of the related cash flows as arising from operating or financing activities.

Reverse factoring arrangements must also be included in an entity's liquidity risk disclosures (see the section on 'Liquidity risk management' for more details).

In addition, an entity must disclose the judgements that management has made in respect of how to present liabilities and cash flows related to reverse factoring arrangements if they are among the judgements made that have the most significant effect on the amounts recognised in the financial statements (IAS 1:122). An entity must also provide information about reverse factoring arrangements in its financial statements to the extent that such information is relevant to an understanding of those financial statements (IAS 1:112).

At the time of writing, finalisation of the Committee's position is expected by the end of 2020. This should be considered carefully by entities engaged in supplier financing arrangements.

Disclosure of changes in liabilities from financing activities

Regulators continue to point out improvements needed to an entity's disclosures of change in liabilities from financing activities required by IAS 7 *Statement of Cash Flows*. In September 2019, the IFRS Interpretations Committee published an agenda decision that reminds entities about the disclosure objective and makes it clear that a reconciliation alone might not be sufficient.

It should be noted that the reconciliation suggested in IAS 7 is different from a net debt reconciliation that has been historically presented in some jurisdictions, because it should only present movements in liabilities arising from financing activities and not movements in a net debt balance, which often includes cash and other assets that do not give rise to financing cash flows. In summary, the reconciliation required by IAS 7 should:

- not include any cash or cash equivalent balances;
- include all liabilities that give rise to cash flows that are classified as financing activities in the statement of cash flows (e.g. borrowings or lease liabilities, as well as supplier payables if they form part of the entity's financing activities);
- include all derivatives that give rise to cash flows that are classified as financing activities in the statement of cash flows, for example because they are hedging instruments for a liability that gives rise to financing cash flows;
- include both changes arising from cash flows and non-cash changes; and
- reconcile with the statement of cash flows.

Reporting the effects of income tax

The reporting of income tax remains an area of regulatory and investor focus, especially given the circumstances of the COVID-19 pandemic.

In respect of financial statements, the effective tax rate reconciliation required by IAS 12 *Income Taxes* is an important source of information on the sustainability of an entity's effective tax rate and the factors affecting it. The nature of reconciling items and why they have arisen should be clearly explained and a clear distinction drawn between significant one-off or unusual items and those that are expected to recur.

Income tax is a common source of estimation uncertainty, particularly in respect of uncertain tax positions, to be disclosed in accordance with IAS 1. Significant risks of material adjustment in the next financial year should be disclosed, including quantitative information such as sensitivities or ranges of possible outcomes. The possibility of material adjustments in later periods is also valuable information which could be included in, for example, the tax note.

A Deloitte *IFRS in Focus* 'Accounting considerations related to the Coronavirus 2019 Disease' provides more detail on how COVID-19 can affect an entity's reporting on income taxes, including the recognition of deferred tax assets and the assessment of future taxable profits.

While we have highlighted a number of areas that may be affected by the consequences of COVID-19, the list is much longer. The Deloitte *IFRS in Focus* 'Accounting considerations related to the Coronavirus 2019 Disease' addresses several other areas, including:

- Events after the end of the reporting period
- Restructuring plans and onerous contracts provisions
- Government assistance
- Classification of financial assets, debt modifications, changes in estimated cash flows, hedge accounting and contracts to buy/sell commodities
- Employee benefits and share-based payments
- Insurance recoveries
- Consolidation, acquisitions and disposals

Brexit and 2020 financial statements

Regulators continue to highlight the importance of disclosure of the possible effects on the entity of the United Kingdom's decision to leave the European Union. It should be assumed that December 2020 financial statements of entities with material operations in the United Kingdom will include commentary on the possible effects of Brexit on the entity's results and future prospects. This commentary is likely to include a more granular analysis of the effects of the end of the transition period for December 2020 financial statements.

The significant uncertainties and unknowns in respect of the final terms of the United Kingdom's departure will be resolved to some extent towards or after the end of the transition period (31 December 2020). This means that a comprehensive review for events after the reporting period should be incorporated into the year-end reporting plan, in order to identify both adjusting and non-adjusting events and to make the necessary disclosures required by IAS 10 *Events after the Reporting Period*.

Whilst more clarity is expected by the end of 2020, the full economic impact of Brexit may not be apparent immediately. It is expected that entities will continue to face challenges with regard to estimates and projections and will need to provide relevant disclosures.

Interest Rate Benchmark Reform

Interest rate benchmarks such as interbank offered rates (IBORs) play a key role in global financial markets and index trillions of dollars in financial products. Work is underway in multiple jurisdictions to transition to alternative risk free rates (RFRs). This is intended to result in rates that are more reliable and provide a robust alternative for products and transactions that do not need to incorporate the credit risk premium embedded in the IBORs.

Phase 1

In 2019, the Board has issued *Interest Rate Benchmark Reform—Amendments to IFRS 9, IAS 39 and IFRS 7* to address accounting issues arising from the uncertainty about the long-term viability of some existing interest rate benchmarks.

These amendments modify specific hedge accounting requirements to enable entities to apply hedge accounting assuming that the interest rate benchmark on which the hedged cash flows and cash flows of the hedging instrument are based is not altered as a result of the interest rate benchmark reform.

The amendments apply to annual periods beginning on or after 1 January 2020.

A Deloitte *IFRS in Focus* provides more details on the Phase 1 amendments.

A Deloitte *A Closer Look* illustrates financial instruments disclosures when applying Interest Rate Benchmark Reform – Phase 1 and Phase 2.

Phase 2

In 2020, the Board issued *Interest Rate Benchmark Reform—Phase 2 (Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16).*

These amendments enable entities to reflect the effects of transitioning from benchmark interest rates, such as IBORs, to alternative benchmark interest rates without giving rise to accounting impacts that would not provide useful information to users of financial statements.

The amendments affect many entities and in particular those with financial assets, financial liabilities or lease liabilities that are subject to interest rate benchmark reform and those that apply the hedge accounting requirements in IFRS 9 or IAS 39 *Financial Instruments: Recognition and Measurement* to hedging relationships that are affected by the reform. Entities are required to provide disclosures on the nature and extent of risks arising from the interest rate benchmark reform, how those risks are managed, how the transition is managed including the progress made in completing the transition from interest rate benchmarks to alternative benchmark interest rates.

The amendments apply to all entities and are not optional. They are effective for annual periods beginning on or after 1 January 2021 with early application permitted. The amendments are applied retrospectively and include reinstatement of hedge relationships that were discontinued solely due to changes directly required by the reform.

A Deloitte *IFRS in Focus* provides more details on the Phase 2 amendments.

A Deloitte *A Closer Look* illustrates financial instruments disclosures when applying Interest Rate Benchmark Reform - Phase 1 and Phase 2.

Climate change

There is an increasing expectation from investors and regulators that entities reflect the effects of climate change in their financial statements and provide appropriate disclosures of the related judgements and estimates.

An IFRS Foundation publication 'IFRS Standards and climate-related disclosures' authored by Nick Anderson and building on an earlier publication by the Australian Accounting Standards Board (AASB) and Audit and Assurance Board (AUASB), discusses the potential implications arising from climate-related and other emerging risks on financial statements prepared applying IFRS Standards. The IFRS Foundation has also published education material to complement this publication.

An open letter from the Principles for Responsible Investment group makes clear that the expectations on both preparers and auditors in respect of reflecting the effects of climate change will both increase and become more specific (in terms of the additional considerations and disclosures expected) as compared to previous years.

And in November 2020, the Institutional Investors Group on Climate Change (IIGCC – a pan-European group of investors representing assets worth over €33 trillion) released a report setting out "investor expectations that directors and auditors deliver Paris-aligned accounts – accounts that properly reflect the impact of getting to net-zero emissions by 2050 for assets, liabilities, profits and losses." The report goes on to state that "[o]nly then will management, investors and creditors have the information they require to deploy capital in a way that is consistent with the Paris Agreement". It calls for action by directors, audit committees and auditors to meet this objective and for the application of the requirements highlighted in the IFRS Foundation's publication 'In Brief: IFRS Standards and climate-related disclosures'.

For more detail on how climate change may affect financial statements, please see the following:

- A Deloitte *A Closer Look* 'Investor demand for corporate reporting in line with the Paris Agreement on climate change'
- A Deloitte *IFRS in Focus* 'Task-force on Climate-related Financial Disclosures issues its final report'
- Deloitte climate change website

Currency and hyperinflation

Increasing levels of inflation and restrictions on exchange between local and internationally traded currencies are a feature of some economies around the world. These issues present financial reporting challenges in:

- Determining whether an economy is hyperinflationary (as that term is defined in IAS 29 *Financial Reporting in Hyperinflationary Economies,* which includes several characteristics of hyperinflation, including a cumulative inflation rate over three years that approaches or exceeds 100%) and, if so, which general price index should be applied to amounts in the financial statements.
- Determining an entity's functional currency in circumstances where both a local and international currency are in common use. This can be particularly significant where the local currency is hyperinflationary as IAS 29 is only applied by entities whose functional currency is the currency of a hyperinflationary economy (rather than by any entity operating in that economy).
- Identifying a suitable exchange rate for translating monetary items in individual financial statements and in retranslating the financial statements of a foreign operation in its parent's presentation currency.

When inflation or exchange issues result in a significant judgement or give rise to a source of estimation uncertainty, disclosure should be provided as required by IAS 1:122 and 125.

Based on data available at the time of writing, including inflation forecasts from the International Monetary Fund (IMF) and the indicators laid out in IAS 29, the following economies should be considered hyperinflationary economies for the purposes of applying IAS 29 and for retranslation of foreign operations in accordance with IAS 21 *The Effect of Changes in Foreign Exchange Rates* in financial statements for the year ending 31 December 2020:

- Argentina
- Islamic Republic of Iran
- Lebanon
- South Sudan
- Sudan
- Syrian Arab Republic
- Venezuela
- Zimbabwe

At the time of writing, forecasts by the IMF indicate that the Republic of Suriname may be considered to have a hyperinflationary economy by the end of December 2020. Entities concerned should monitor the situation to determine whether this is the case.

Other topics of regulatory focus

Statement of cash flows

In addition to the requirements on changes in financing liabilities and the need for clarity on the treatment of supplier financing and factoring arrangements discussed above, the reporting of cash flows more generally remains an area of focus. In particular, care should be taken in determining the correct classification of cash flows. Common pitfalls include:

- Non-cash transactions (like commencement of a lease) should be appropriately excluded from the statement of cash flows.
- Proceeds from new borrowings and repayments of borrowings should not be offset and instead be reported on a gross basis.
- Dividends received from associates and joint ventures or net cash paid on acquisitions must be disclosed.
- Acquisition-related costs and consideration for post-acquisition services should be classified as cash flows from operating activities.
- Cash flows from acquisition of non-controlling interests should be classified as financing activities.
- Cash flows from derivatives accounted for as hedging instruments should be classified in the same category as the cash flows of the position being hedged.

Provisions and contingent liabilities

The recognition and measurement of provisions is an inherently judgemental area and clear disclosure of the key judgements involved is important, e.g. about the point at which an obligation arises and uncertainties in the amount and timing of subsequent cash flows.

In addition, entities should consider the following when providing disclosures about provisions:

- Disclosures should be sufficiently detailed (e.g. where provisions were for third-party claims, this should be further explained, including their timing).
- Provisions of different classes must not be aggregated (e.g. onerous contract provisions must not be aggregated with provisions for legal, commercial and regulatory claims).
- It should be explained how restructuring provisions meet the recognition criteria set out in IAS 37 P*rovisions, Contingent Liabilities and Contingent Assets*, which state that a provision shall be recognised when there is a present obligation, the outflow of resources embodying economic benefits is probable and a reliable estimate can be made.
- Provisions and related insurance reimbursements should be presented on a gross basis in the statement of financial position.
- Sufficient information should be provided to support the conclusion that recovery of insurance reimbursement assets was virtually certain.

Fair value measurement

Similarly, the determination of fair value, particularly when the use of unobservable 'Level 3' inputs is required, can be a subjective exercise. Clear disclosure of the valuation techniques used and of significant unobservable inputs and sensitivities should be provided to enable investors understand the estimates involved.

The following have been identified by regulators as sources of frequent shortcomings:

- Sensitivities of fair values should be described, especially with regard to non-financial assets. The sensitivity analyses should illustrate the effect of a reasonably possible change in key assumptions.
- If the choice of valuation technique requires judgement, this needs to be adequately explained.
- If entities use labels like 'other financial assets' or 'other financial liabilities', they need to explain what the amounts represent and how the fair values are determined.
- If entities make company-specific adjustments to established valuation techniques, these must be explained in sufficient detail.
- Valuation inputs and assumptions (e.g. discount rates) must be consistent with those used in other sections of the financial statements.
- Fair value less cost of disposal for a subsidiary must not significantly exceed the subsidiary's market capitalisation when the subsidiary is listed.
- Fair value hierarchy disclosures must include all recurring and non-recurring fair value measurements.
- Opening and closing balances of items categorised as Level 3 must be reconciled.

Appendices

New and revised IFRS Standards and Interpretations mandatorily effective for years ending 31 December 2020

Amended Standards:

- Amendments to IFRS 3 *Business Combinations—Definition of a Business*
- Amendments to the *Conceptual Framework for Financial Reporting*, including amendments to references to the *Conceptual Framework in IFRS Standards*
- Amendments to IAS 1 and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors—Definition of Material*
- Amendments to IFRS 9, IAS 39 and IFRS 7—*Interest Rate Benchmark Reform*

Amendments to IFRS 3—Definition of a Business
The amendments to IFRS 3 include:

- Clarification that to be considered a business, an acquired set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs.
- Additional guidance to help determine whether a substantive process has been acquired. New illustrative examples assist with the interpretation of what is considered a business.
- Removal of the assessment of whether market participants are capable of replacing any missing inputs or processes and continuing to produce outputs.
- The definitions of a business and of outputs are narrowed by focusing on goods and services provided to customers. The reference to an ability to reduce costs is removed.
- An optional concentration test permits a simplified assessment of whether an acquired set of activities and assets is not a business – it is not a business if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets.
- A reminder to apply judgement where it is not clear whether an integrated set of activities and assets should be regarded as a business.

A Deloitte *IFRS in Focus* provides more details on the amendments to IFRS 3—*Definition of a Business*.

Amendments to references to the Conceptual Framework in IFRS Standards
When publishing the revised *Conceptual Framework* in 2018, the IASB has published a separate document *Updating References to the Conceptual Framework,* which contains consequential amendments to Standards that included references to the 1989 and 2010 versions of the *Framework* so that they refer to the new *Framework*.

A Deloitte *IFRS in Focus* provides more details on the revised *Conceptual Framework* including the consequential amendments to IFRS Standards.

Amendments to IAS 1 and IAS 8—Definition of Material
The amendments are intended to make the definition of material in IAS 1 easier to understand and are not intended to alter the underlying concept of materiality in IFRS Standards. The amendments also make the following changes:

- The concept of 'obscuring' material information with immaterial information has been included as part of the new definition.
- The threshold for materiality influencing users has been changed from 'could influence' to 'could reasonably be expected to influence'.
- The definition of material in IAS 8 has been replaced by a reference to the definition of material in IAS 1. In addition, the IASB amended other Standards and the *Conceptual Framework* that contain a definition of material or refer to the term 'material' to ensure consistency.

A Deloitte *IFRS in Focus* provides more details on the amendments to IAS 1 and IAS 8—*Definition of Material.*

Amendments to IFRS 9, IAS 39 and IFRS 7—Interest Rate Benchmark Reform (Phase 1)
The amendments to IFRS 9, IAS 39 and IFRS 7:

- Affect entities that apply the hedge accounting requirements of IFRS 9 or IAS 39 to hedging relationships directly affected by the interest rate benchmark reform.
- Modify specific hedge accounting requirements, so that entities would apply those hedge accounting requirements assuming that the interest rate benchmark is not altered as a result of the interest rate benchmark reform.
- Mandatorily apply to all hedging relationships that are directly affected by the interest rate benchmark reform.
- Are not intended to provide relief from any other consequences arising from the interest rate benchmark reform. If a hedging relationship no longer meets the requirements for hedge accounting for reasons other than those specified by the amended Standards, then discontinuation of hedge accounting is still required.
- Are applied retrospectively to those hedging relationships that existed at the beginning of the reporting period in which an entity first applies the amendments or were designated thereafter, and to the gain or loss recognised in other comprehensive income that existed at the beginning of the reporting period in which an entity first applies the amendments.

A Deloitte *IFRS in Focus* provides more details on the Amendments to IFRS 9, IAS 39 and IFRS 7—*Interest Rate Benchmark Reform (Phase 1).*

IFRS Interpretations Committee agenda decisions in 2020

Along with its activity developing formal interpretations of IFRS Standards and proposing that the IASB make amendments to Standards, the IFRS Interpretations Committee regularly publishes summaries of issues that it has decided not to add to its agenda, often accompanied by a discussion of the accounting issue submitted.

In August 2020, The Trustees of the IFRS Foundation issued an updated IFRS Foundation Due Process Handbook establishing that the explanatory material in the agenda decisions published by the IFRS Interpretations Committee derives its authority from the IFRS Standards themselves and, therefore, that its application is required.

The IFRS Foundation Due Process Handbook also notes that it is expected that an entity would be entitled to sufficient time to make that determination and implement any necessary accounting policy change (for example, an entity may need to obtain new information or adapt its systems to implement a change). Determining how much time is sufficient to make an accounting policy change is a matter of judgement that depends on an entity's particular facts and circumstances. Nonetheless an entity would be expected to implement any change on a timely basis and, if material, consider whether disclosure related to the change is required by IFRS Standards.

The following agenda decisions have recently been published by the Committee:

November 2019 IFRIC Update	IFRS 16 and IAS 16 *Property, Plant and Equipment*— Lease Term and Useful Life of Leasehold Improvements
January 2020 IFRIC Update	IFRS 16—Definition of a Lease—Decision-making Rights
March 2020 IFRIC Update	IAS 21 and IAS 29—Translation of a Hyperinflationary Foreign Operation—Presenting Exchange Differences
	IAS 21 and IAS 29—Cumulative Exchange Differences before a Foreign Operation becomes Hyperinflationary
	IAS 21 and IAS 29—Presenting Comparative Amounts when a Foreign Operation first becomes Hyperinflationary
	IFRS 15—Training Costs to Fulfil a Contract
April 2020 IFRIC Update	IAS 12—Multiple Tax Consequences of Recovering an Asset
June 2020 IFRIC Update	IFRS 16—Sale and Leaseback with Variable Payments
	IAS 12—Deferred Tax related to an Investment in a Subsidiary
	IAS 38 *Intangible Assets*—Player Transfer Payments

New and revised IFRS Standards and Interpretations available for early application in years ending 31 December 2020

IAS 8:30 requires entities to consider and disclose the potential impact of new and revised IFRS Standards that have been issued but are not yet effective. As discussed above, the sufficiency of these disclosures is a current area of regulatory focus.

The list below reflects a cut-off date of 30 November 2020. The potential impact of the application of any new and revised IFRS Standards issued by the Board after that date, but before the financial statements are issued, should also be considered and disclosed.

For each, a link is provided to a Deloitte *IFRS in Focus* publication presenting an overview of the new or amended IFRS Standard.

IFRS	Effective date—periods commencing on or after:
New Standards	
IFRS 14 *Regulatory Deferral Accounts*	First-time adopters whose first annual IFRS financial statements are for a period beginning on or after 1 January 2016.
IFRS 17 *Insurance Contracts* including *Amendments to IFRS 17*	1 January 2023
Amended Standards	
Amendments to IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*—*Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*	The IASB decided in December 2015 to defer indefinitely the effective date of these amendments. Early application is permitted.
Amendment to IFRS 16—*Covid-related Rent Concessions*	1 June 2020
Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 *Insurance Contracts* and IFRS 16—*Interest Rate Benchmark Reform—Phase 2*	1 January 2021
Amendments to IFRS 3—*Reference to the Conceptual Framework*	1 January 2022
Amendments to IAS 16—*Property, Plant and Equipment—Proceeds before Intended Use*	1 January 2022
Amendments to IAS 37—*Onerous Contracts—Cost of Fulfilling a Contract*	1 January 2022
Amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*, IFRS 9, IFRS 16 and IAS 41 *Agriculture*—*Annual Improvements to IFRS Standards 2018-2020*	1 January 2022, except for the amendment to IFRS 16 for which no effective date is stated as it regards only an illustrative example.
Amendments to IAS 1—*Classification of Liabilities as Current or Non-current* including *Classification of Liabilities as Current or Non-current—Deferral of Effective Date*	1 January 2023

The Deloitte Accounting Research Tool (DART) is a comprehensive online library of accounting and financial disclosures literature. iGAAP on DART allows access to the full IFRS Standards, linking to and from:

- Deloitte's authoritative, up-to-date, iGAAP manuals which provide guidance for reporting under IFRS Standards; and
- Model financial statements for entities reporting under IFRS Standards.

To apply for a subscription to DART, click here to start the application process and select the iGAAP package.

For more information about DART, including pricing of the subscription packages, click here.

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