IFRS in Focus

Accounting considerations related to the Coronavirus 2019 Disease

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Introduction

The coronavirus 2019 (COVID-19) pandemic is affecting economic and financial markets with entities experiencing conditions often associated with a general economic downturn. This includes, but is not limited to, financial market volatility and erosion, deteriorating credit, liquidity concerns, further increases in government intervention, increasing unemployment, broad declines in consumer discretionary spending, increasing inventory levels, reductions in production because of decreased demand, layoffs and furloughs, and other restructuring activities. The continuation of these circumstances could result in an even broader economic downturn which could have a prolonged negative impact on an entity's financial results.

In its *Statement on Importance of Disclosure about COVID-19* published on 29 May 2020, the International Organization of Securities Commissions (IOSCO) notes that "particularly in an environment of heightened uncertainty, it is important that financial reporting include disclosures that provide an adequate level of transparency and is entity-specific regarding uncertainties inherent in judgments and estimates. 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. Telling the story in a clear manner through the financial statements and management commentary is important to investors' information needs and confidence. Issuers should not limit disclosures to boilerplate discussion on COVID-19 itself, but to explain; (i) how COVID-19 impacted and/or is expected to impact the financial performance, financial position and cash flows of the issuer, (ii) how the strategy and targets of the issuers have been modified to address the effects of COVID-19 and (iii) measures taken to address and mitigate the impacts of the pandemic on the issuer".

This *IFRS in Focus* discusses certain key IFRS accounting considerations related to conditions that may result from the COVID-19 pandemic. The significance of the individual issues discussed below will of course vary by industry and by entity, but we believe that the following topics will be the most pervasive and difficult to address.

- *Preparation of forecast cash flow estimates*—The use of forecast information is pervasive in an entity's assessment of, among other things, the impairment of non-financial assets, expected credit losses, the recoverability of deferred tax assets and the entity's ability to continue as a going concern. Unique complexities associated with preparing forward-looking information as a result of the pandemic and economic downturn include the following:

– There is an extremely wide range of possible outcomes, resulting in a particularly high degree of uncertainty about the ultimate trajectory of the pandemic and the path and time needed for a return to a "steady state."

– The associated economic impact of the pandemic is highly dependent on variables that are difficult to predict. Examples include the degree to which governments prohibit business and personal activities, the associated level of compliance by citizens, the degree to which "flattening the curve" is successful, and the nature and effectiveness of government assistance.

– Each entity must then translate the effect of those macro conditions into estimates of its own future cash flows.

Nevertheless, entities will need to do their best to make reasonable estimates, prepare comprehensive documentation supporting the basis for such estimates and provide robust disclosure of the significant judgements exercised, the key assumptions used and, potentially, their sensitivity to change.

- *Recoverability and impairment of assets*—Perhaps the most acute example of the increased challenge associated with forecast information is the impairment testing for non-financial assets (for example, property, plant and equipment (PP&E), right-of-use assets, intangible assets and goodwill). The impairment test for these assets often requires the development of cash flow projections that are subject to the significant uncertainties noted above.

- *Accounting for financial assets*—There has been a severe decline in the fair value of many financial assets, particularly equity securities. Likewise, the ability of debtors to comply with the terms of loans and similar instruments has been adversely affected. Entities will need to carefully consider and apply the appropriate measurement and impairment loss recognition requirements.

- *Contract modifications*—Changes in the economic activity caused by the pandemic will cause many entities to renegotiate the terms of existing contracts and arrangements. Examples include contracts with customers, compensation arrangements with employees, leases and the terms of many financial assets and liabilities. Entities will need to ensure that the relevant requirements in IFRS Standards are applied.

- *Events after the end of the reporting period*—It may be challenging for an entity to determine if an event after the end of the reporting period is adjusting or non-adjusting in a global marketplace that is extremely volatile and in which major developments occur daily (e.g. announcements of government stimuli and restrictions) and the stock market's daily reaction to new information. Although entities may not have all facts "on hand" at the reporting date, once such facts are gathered an assessment must be based on conditions as they existed at the reporting date. The amounts in the financial statements must be adjusted only to reflect subsequent events that provide evidence of conditions that existed at the reporting date. With respect to reporting periods ending on or before 31 December 2019, it is generally appropriate to consider that the effects of the COVID-19 outbreak on an entity are the result of events that arose after the reporting date, for example decisions made in response to the COVID-19 outbreak, that may require disclosure in the financial statements, but would not affect the amounts recognised. For subsequent reporting periods, the effects of the COVID-19 pandemic may affect the recognition and measurement of assets and liabilities in the financial statements. This will be highly dependent on the reporting date, the specific circumstances of the entity's operations and the particular events under consideration.

- *Going concern*—As a result of COVID-19 and its associated effects, entities need to consider whether, in their specific circumstances, they have the ability to continue as a going concern for at least, but not limited to, 12 months from the reporting date. Management's assessment of the entity's ability to continue as a going concern involves making a judgement, at a particular point in time, about inherently uncertain future outcomes of events or conditions. This will require an entity to consider, among other things, (1) the extent of operational disruption; (2) potential diminished demand for products or services; (3) contractual obligations due or anticipated within one year; (4) potential liquidity and working capital shortfalls; and (5) access to existing sources of capital (e.g. available line of credit, government aid). In making its going concern assessment, IAS 10 *Events after the Reporting Period* requires an entity to consider events up to the date of authorisation of the financial statements. In certain jurisdictions, regulations may extend this period (e.g. until presentation of the financial statements at an annual shareholders' meeting).

Entities must carefully consider their unique circumstances and risk exposures when analysing how recent events may affect their financial statements. Specifically, financial statement disclosures will need to convey the material effects of the COVID-19 pandemic.

Material judgements and estimates

As a result of the uncertainty associated with the unprecedented nature of the COVID-19 pandemic, entities are likely to face challenges related to selecting appropriate assumptions and developing reliable estimates. Nevertheless, they will still be required by IFRS Standards to develop estimates that underlie various accounting conclusions. To develop estimates, entities will need to consider all available information as well as whether they have met all applicable disclosure requirements, including those in IAS 1 *Presentation of Financial Statements*.

A number of assumptions or estimates may be required for more than one purpose (e.g. forecast revenues may be relevant to impairment tests and recognition of deferred tax assets). Consistent assumptions should be used for all relevant assessments.

When reporting in uncertain times, 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.

Depending on an entity's specific circumstances, each of the areas discussed in this publication may be a source of material judgement and uncertainty that requires disclosure applying IAS 1. Where this is the case, the entity should provide disclosures, distinguishing between:

- Significant judgements (disclosure required by IAS 1:122), i.e. judgements other than estimations made in applying an entity's accounting policies, often as to how an item is characterised; and
- Significant sources of estimation uncertainty (disclosure required by IAS 1:125, if the source of estimation uncertainty results in a significant risk of material adjustment to assets or liabilities within the next financial year), i.e. assumptions or other sources of estimation uncertainty (including judgements involving estimation), primarily over the carrying amount of an item.

In the current situation, it would appear reasonable for entities not to be bound by a narrow interpretation of what constitutes a significant source of estimation uncertainty and provide as much context as possible for the assumptions and predictions underlying amounts recognised in the financial statements, in line with the spirit of the requirements of IAS 1:125.

Relevant judgements and assumptions might include the:

- availability and extent of support through government support measures that have been announced;
- availability, extent and timing of sources of cash, including compliance with banking covenants or reliance on those covenants being waived;
- duration of social distancing measures and their potential impacts.

There is not a single view on how the COVID-19 pandemic will evolve and its impact on the economy. This uncertainty makes the need for full disclosure of judgements, assumptions and sensitive estimates significantly more important than usual.

The disclosure provided about the key assumptions, including the sensitivity analysis based on a range of reasonably possible outcomes, should reflect the conditions at the reporting date. When key assumptions, or the range of reasonably possible changes to those assumptions, are affected significantly as a result of non-adjusting events after the reporting date, information about those changes, including an estimate of the financial effect, should be provided separately (see Events after the end of the reporting period).

A Deloitte *IFRS in Focus* publication provides more detail on the disclosure of significant judgements and sources of estimation uncertainty.

Going concern

COVID-19 is disrupting operations of many businesses. Entities will need to consider whether such disruption will be prolonged and result in diminished demand for products or services or significant liquidity shortfalls (or both) that, among other things, cause management to assess whether the entity may be able to continue as a going concern for at least, but not limited to, 12 months from the reporting date.

Financial statements are prepared on a going concern basis unless management intends either to liquidate the entity or to cease trading, or has no realistic alternative but to do so. When making its assessment, if management is aware of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity must disclose those uncertainties.

An entity's current facts and circumstances may challenge the going concern basis of preparation. Assessing whether an entity is a "going concern" typically requires the following factors to be considered:

- Whether the forecast performance would result in an adequate level of headroom over the entity's available borrowing facilities and compliance with relevant loan covenants; and
- The availability of sufficient committed borrowing facilities for the foreseeable future and whether there are indicators that the lending counterparty will be unable to provide this funding.

In the current situation, the assessment is made more difficult given the uncertainties about the impact of the COVID-19 pandemic, the extent and duration of social distancing measures in effect in many jurisdictions and the impact on the economy. Management should consider the impact of these matters on the *entity's specific circumstances*, in particular current and potential cash resources including access to existing and new financing facilities, and factoring and reverse factoring arrangements. Access and use of such facilities and arrangements should be disclosed.

The assessment as to whether the going concern basis is appropriate takes into account events after the end of the reporting period. For example, 31 December 2019 reporters that are severely affected by COVID-19, even though the significant impact on operations occurred after year-end, will need to consider the appropriateness of preparing financial statements on a going concern basis.

In making this assessment, management will need to take into account all information available up to the date of authorisation of the financial statements (in certain jurisdictions, local regulations may extend this period). The information to be considered includes government announcements affecting the ability of an entity to operate and of any government assistance programmes to which the entity may be entitled. 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 the 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 should 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).

Given the current uncertainty and the variety of outcomes still possible related to the course of the pandemic and its adverse impact on economies all over the world, entities will need to consider a wide range of factors related to current and expected profitability, among other things. There may be cases when an entity concludes, after having considered all relevant information, including the feasibility and effectiveness of planned mitigation, that there are no material uncertainties that cast substantial doubt about its ability to continue as a going concern requiring disclosure under IAS 1:25.

However, in this current climate, reaching that conclusion will often involve significant judgements around the range of outcomes to consider and the probabilities assigned to those outcomes. Furthermore, the range of possible outcomes and their impact on the entity's future operations may be broad, meaning that assigning more or less weight to possible outcomes could make a difference in the entity's conclusion regarding the existence of material uncertainties.

IAS 1:122 requires disclosure of the judgements made that have the most significant impact on the amounts recognised in the financial statements. IAS 1:122 also requires disclosure of the significant judgements which the entity has made to reach the conclusion that no disclosure of material uncertainties is required under IAS 1:25, especially when other reasonable judgements may have resulted in a different conclusion. This is consistent with the conclusion reached by the IFRS Interpretations Committee in the July 2014 *IFRIC Update* 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. Such disclosure is important to provide users of the financial statements with sufficient information to understand the pressures on liquidity, viability and solvency.

Even if an entity concludes that there is no material uncertainty regarding its ability to continue as a going concern, information that may be relevant to users of the financial statements includes:

- the different going concern scenarios that have been considered;
- inputs that have been subject to stress tests and an explanation of how these stress tests have affected the going concern conclusions;
- any mitigating actions management is able to take to improve liquidity;
- any post balance sheet changes to liquidity, specifically the arrangement of new lending facilities, the extension of existing facilities or the renegotiation of debt instruments or facilities or waiving of loan covenants;
- the level of drawn and undrawn finance facilities in place;
- the covenants in place and whether they are expected to be breached; and
- the need for structural changes in order for the entity to continue to operate as a going concern.

Entities should also consider any additional expectations relating to disclosure of these matters that have been articulated by regulators in their jurisdictions.

Events after the end of the reporting period

Given the economic environment and the likelihood that events may occur rapidly or unexpectedly, entities should carefully evaluate information that becomes available after the end of the reporting period but before the date of authorisation of the financial statements.

The amounts in the financial statements must be adjusted to reflect events after the end of the reporting period that provide evidence of conditions that existed at the end of the reporting period. Events that are indicative of conditions that arose after the reporting period are non-adjusting events. They are not reflected in the recognition or measurement of items in the financial statements, but require disclosure when material.

Often the "events" are (1) company-specific; and (2) associated with a specific account that permits a more precise analysis. However, sometimes the "events" are macroeconomic in nature (such as those resulting from COVID-19) and have a pervasive impact on many estimates in a set of financial statements which may make it difficult to ascertain whether such conditions "existed" at the reporting date. The full impact of the COVID-19 pandemic on short-term, medium-term, and long-term economic activity is still unknown, and major developments are occurring frequently. However, COVID-19 will be a factor in an entity's analysis of estimates made in the preparation of the financial statements, including those related to the expected credit loss on receivables, inventory obsolescence, impairment analyses, variable and contingent consideration estimates, and other factors. Whilst the events stemming from COVID-19 are extremely volatile, entities will nevertheless be required to consider conditions as they existed at the reporting date when evaluating subsequent events.

With respect to reporting periods ending on or before 31 December 2019, it is generally appropriate to consider that the effects on an entity are the result of events that arose after the reporting date that may require disclosure in the financial statements but would not affect the amounts recognised.

For subsequent reporting dates, entities will need to judge how much of the impact of COVID-19 should be considered to arise from non-adjusting events. This will be highly dependent on the reporting date, the specific circumstances of the entity's operations and the particular events under consideration. In other words, there is no universal 'flip' point at which entities should view all COVID-19 related impacts to be adjusting events. Instead, each event should be assessed to determine whether it provides evidence of conditions that existed at the end of the reporting period or whether it reflects a change in conditions after the reporting date.

If non-adjusting events are material, an entity is required to disclose the nature of the event and an estimate of its financial effect. The estimate does not need to be precise. It is preferable to provide a range of estimated effects as an indication of impact to not providing any quantitative information at all. However, where quantitative effect cannot be reasonably estimated, qualitative description should be provided, along with a statement that it is not possible to estimate the effect.

Statement of profit or loss

IAS 1:97 requires that "[w]hen items of income or expense are material, an entity shall disclose their nature and amount separately". The impact of COVID-19 may give rise to material expense or income items for many entities, for example restructuring provisions and impairment losses related to non-financial assets. When it is practicable to identify specifically and quantify such discrete items, they should be disclosed separately either in the statement of profit or loss and other comprehensive income or in the notes to the financial statements, with appropriate explanation of those amounts.

An entity should also consider the requirements in IAS 1:85 to present additional line items, headings or subtotals when such a presentation is relevant to an understanding of the entity's financial performance. However, the presentation of items as being "extraordinary" is specifically prohibited by IAS 1:87.

In determining if an item should be presented separately, or a heading or subtotal added, an entity should consider:

- The nature and magnitude of the costs; and
- The rationale for creating a new header or subtotal and its usefulness.

Caution should be used when excluding certain items from "operating profit" if such a subtotal is presented. Additional requirements from local regulations that may restrict the format used in presenting the statement of profit or loss will also need to be considered.

The impacts of COVID-19 are macroeconomic and affect all entities. 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. As discussed above, 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 of the impacts of COVID-19 on an entity's performance may be difficult without use of arbitrary assumptions. 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. In fact, such "pro forma" presentation would not comply with the requirements of IAS 1:99 to present an analysis of expenses using a classification based on either their nature or their function. Likewise, it would not be appropriate to consider that the function of costs presented according to function has changed due to the effects of COVID-19 (for instance depreciation in respect of factory or premises that are closed for a period of time due to government measures). Any additional information that entities seek to include to explain the impact of COVID-19 should instead be included in the notes to financial statements or other financial communications. However, consideration should be given to regulatory and other requirements related to the provision of alternative or non-IFRS measures.

In certain jurisdictions, practices exist whereby entities present a three-column statement of profit or loss or use other presentations to show 'underlying' results. Practices vary, but often such adjustments are made to facilitate the year-on-year assessment of results, or because they are not seen as forming part of the underlying activities of the entity or, in the opinion of management, their separate presentation enhances understanding of the financial performance of the entity and its businesses. 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 and should not be excluded from 'underlying' results presented in the statement of profit or loss.

Alternative performance measures

Because of the significant impact of COVID-19 on their performance and financial position, entities may consider to provide new alternative performance measures (APMs) or adjust existing APMs.

The use of APMs has been an area of regulatory concern in many jurisdictions around the world, with the International Organization of Securities Commissions ("IOSCO") publishing a Final Statement on Non-GAAP Financial Measures in 2016. ESMA, the European Securities and Markets Authority, also issued Guidelines on Alternative Performance Measures ('APM Guidelines') that are consistent with those of IOSCO.

In its Statement on Importance of Disclosure about COVID-19 published 29 May 2020, 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."

In April 2020, ESMA issued a new Q&A (Q&A 18) which explains considerations an entity should make before publishing new and/or modified APMs to present the impact of COVID-19.

In particular, ESMA notes that:

- The definition and calculation of an APM should be consistent over time. Therefore, caution should be used when making adjustments to APMs currently used and/or when including new APMs solely to depict the impacts that COVID-19 may have on an entity's performance and cash flows.
- New/adjusted APMs must provide a fair review of the development, performance and financial position of the entity. Conversely, they must not provide an incorrect depiction of the entity's performance.
- An entity should carefully assess whether the intended adjustments or new APMs would provide transparent and useful information to the market, improve comparability, reliability and/or comprehensibility of APMs and of the financial information disclosed to the market.
- An entity should explain why it believes that an APM provides useful, reliable and relevant information regarding its financial position, cash flows or financial performance as well as the purposes for which it decided to use a specific APM and/or to modify a previously used APM.
- It may not be appropriate to include new/adjusted APMs when COVID-19 has a pervasive effect on the entity's overall financial performance, position, and/or cash flows. This is because, in such circumstances, these new/adjusted APMs may not provide reliable and more useful information to the market. Instead, the new/adjusted APMs may mislead users' understanding of the true and fair view of the entity's assets, liabilities, financial position and profit or loss.

Significantly, rather than adjusting existing APMs or including new APMs, ESMA urges entities to improve their disclosure and include narrative information in their communication documents to explain:

- how COVID-19 impacted and/or is expected to impact their operations and performance;
- the level of uncertainty and the measures adopted or expected to be adopted to address the COVID-19 outbreak; and
- where applicable, details on how the specific circumstances relating to COVID-19 have affected the assumptions and estimates used in the determination of inputs to APMs, for example impairment losses, expected lease payment reductions or grants received.

The APM Guidelines apply to all financial measures not defined or specified in the applicable financial reporting framework including liquidity and cash flow measures. In this respect, ESMA reminds entities that the APM Guidelines which include the additional Q&A regarding COVID-19 also apply to APMs presented simultaneously inside and outside financial statements. Finally, ESMA also reminds entities that APMs should not be displayed with more prominence than measures directly stemming from financial statements.

Other regulators may have issued guidelines on the use of APMs to present the impact of COVID-19. Entities should refer to guidance issued by the regulators in jurisdiction(s) in which they have filing obligation as their primary source(s) of information.

Impairment of non-financial assets

Assets subject to the requirements of IAS 36

Entities will need to assess whether the impact of COVID-19 has potentially led to an asset impairment. Financial performance, including estimates of future cash flows and earnings, may be significantly affected by the direct or indirect impacts of recent and ongoing events.

IAS 36 *Impairment of Assets* seeks to ensure that an entity's assets are carried at not more than their recoverable amount (i.e. the higher of fair value less costs of disposal and value in use). IAS 36 does not require an entity to monitor constantly assets (including goodwill) for indication of impairment. Instead, IAS 36:9 requires entities to assess at the end of each reporting date (interim and annual) whether there is any indication that assets may be impaired and if such an indication exists to perform an impairment test. In addition, IAS 36:10 requires an entity to test intangible assets with an indefinite useful life, intangible assets not yet available for use and goodwill for impairment annually, at the same time every year. The test is conducted for a 'cash-generating unit' (CGU) when an asset does not generate cash inflows that are largely independent of those from other assets. The CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

The scope of assets subject to the requirements in IAS 36 is broad. It includes property, plant and equipment (carried at cost or revalued amount), intangible assets (carried at cost or revalued amount), goodwill, right-of-use assets (if carried at cost), investment property (if carried at cost), biological assets (if carried at cost) and investments in associates and joint ventures accounted for using the equity method. Note that interests in associates and joint ventures not subject to the equity method, such as loans, are subject to the impairment requirements in IFRS 9 *Financial Instruments*. In an entity's separate financial statements, investments in subsidiaries, associates and joint ventures (other than those accounted for in accordance with IFRS 9) are also subject to the requirements of IAS 36.

Indicators of impairment include (but are not limited to) significant changes with an adverse effect on the entity that have taken place during the period, or will take place in the near future in the market or economic environment in which the entity operates. An entity will also need to consider the extent to which, or the manner in which, an asset is used or is expected to be used (for example, an asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs or plans to dispose of an asset before the previously expected date).

Factors resulting from the COVID-19 pandemic which indicate that the carrying amount of a CGU may not be recoverable may include (1) decreased demand for the entity's products or service; (2) increased costs/business interruptions due to supply chain issues; (3) cancellations or postponements of orders by customers; (4) need to provide significant concessions to customers; (5) significant customers experiencing financial difficulties or cash flow difficulties. These factors may indicate that the entity may be forced to liquidate some of its assets rapidly.

In addition, given recent stock market price declines, the carrying amount of net assets of an entity may exceed its market capitalisation. IAS 36 notes that this situation is a further indicator of impairment.

As a result of the impact of COVID-19, certain entities may need to perform an impairment assessment of assets in addition to the requirement to perform an impairment test at least annually of goodwill and intangible assets with an indefinite useful life.

Entities often rely on discounted cash flows in estimating recoverable amounts. Careful consideration of the cash flow projections, growth rate(s) and discount rate(s) will be critical in terms of the supportability and reasonableness of the calculations given the current market conditions. In particular, the projected cash flows should be based on what could have reasonably been known at the reporting date of the conditions that existed at that date. However, in a value in use calculation, they should not reflect the effects of restructuring plans that are not committed at the reporting date as this would be inconsistent with the requirement to determine the value in use of the CGU in its current condition at the end of the reporting period. Similarly, the benefits of government assistance should be reflected as cash inflows only if there is sufficient understanding at the reporting date of the government assistance programme, so that reasonable supportable estimates can be developed of the amounts to which the entity is expected to be entitled. Depending on the range of possible outcomes for these expected government programmes, it may be more appropriate to use multiple scenarios and a probability-weighted expected value approach to arrive at management's best estimate of future cash flows and recoverable amount, as discussed further below. Factoring in uncertainties about future cash flows in an impairment analysis will require significant judgement. The assumptions made and the probabilities assigned to cash inflows associated with expected government assistance and whether and to what extent the entity will be eligible must be reasonable and supportable based on publicly available information at the reporting date and relevant information obtained after that date that reflects *adjusting* post balance sheet events as defined in IAS 10.

The discount rate to be used is an estimate of the rate that a market participant would expect on an equally risky investment. Hence, to the extent that risk and uncertainties about the future impact of the COVID-19 pandemic are not reflected in the projected cash flows of the CGU being tested, they should be reflected in the discount rate applied.

In these uncertain times, management may face significant challenges in preparing the budgets and forecasts necessary to estimate the recoverable amount of an asset (or CGU). Management may determine that using an expected cash flow approach is the most effective means of reflecting the uncertainties of the COVID-19 pandemic in its estimates of recoverable amount. This approach reflects all expectations about possible cash flows instead of the single expected outcome. For example, a cash flow might be CU100, CU200 or CU300, with probabilities of 10 per cent, 60 per cent and 30 per cent, respectively, giving an expected cash flow of CU220, i.e. (CU100 × 10%) + (CU200 × 60%) + (CU300 × 30%). While an expected cash flow approach is highly dependent on assigning probabilities to estimates of future cash flows, such judgements on the inputs may nevertheless be more transparent and more readily tied to underlying commercial expectations than the addition of a "COVID-19" risk premium to the discount rate that may be more arbitrary and for which there is no evidential base to support the quantum of the adjustment. IAS 36:23 indicates that estimates, averages and other computational short-cuts could also be used to provide reasonable approximations of more detailed computations. However, the use of such approximations should be carefully assessed taking into account the level of risk that an impairment loss exists for the assets being tested.

Key principles to bear in mind are:

- Estimated cash flows and discount rates should be free from both bias and factors unrelated to the asset in question.
- Estimated cash flows should reflect a range of possible outcomes, rather than a single expected outcome.
- Cash flow projections should reflect the conditions in existence at the reporting date and be based on the most recent financial budgets/forecasts, approved by management at the appropriate level of authority, covering a maximum period of five years, unless a longer period can be justified. In these uncertain times, reliable detailed budgets may only be available for a shorter period.

- Projections of cash flows beyond the period covered by the most recent budgets/forecasts should be estimated by extrapolating the projections based on the budgets/forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified based on objective information about patterns over a product or industry lifecycle. This growth rate should not be overly optimistic and should not exceed the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market in which the asset is used, unless a higher rate can be justified. In some cases, it may be appropriate for the growth rate to be zero or negative.
- Future cash flows should be estimated for the asset in its current condition and should not include estimated future cash inflows or outflows expected to arise from improving or enhancing the asset's performance or future restructuring to which the entity is not yet committed (when the recoverable amount is determined as the value in use).
- The entity's weighted average cost of capital (WACC) may be used as a starting point for estimating a market discount rate, but this should then be adjusted to reflect the way the market would assess the cash-generating unit's cash flows (unless that risk is already included in the estimated cash flows). When considering the underlying individual inputs into a traditional capital asset pricing model ("CAPM") consideration must be given to the interplay between inputs (i.e. the risk free rate assumption and the equity risk premium) and how the changes in some inputs may be offset by the change in other inputs. The expectation of a falling risk free rate environment does not necessarily translate into a lower cost of capital.
- Care should be taken as to consistency of the data being prepared and compared to avoid double counting or omission of some data.

If information is received after the end of the reporting period, but before the financial statements are authorised for issue, indicating that an asset is impaired, management should consider whether that information is indicative of impairment that existed at the end of the reporting period. If so, an impairment review (or a re-performance of any impairment test already performed) should be carried out. If the information received after the reporting period is not indicative of conditions existing at the end of the reporting period, it should not trigger an impairment test (or the re-performance of any impairment test already carried out). Rather, the information should be disclosed as a non-adjusting event after the reporting period when it is of such importance that non-disclosure would affect decisions of users of the financial statements.

If there is indication that the asset may be impaired, the underlying facts should be kept in mind when performing the annual reviews of the useful life of the asset, the depreciation or amortisation method used and the estimated residual value. These items may need to be adjusted even if no impairment loss is recognised.

Information about asset impairments will be critical in helping users of the financial statements understand the impact of the COVID-19 pandemic on an entity's financial performance and position. Disclosure of the key assumptions used to determine the recoverable amount, together with a description of management's approach to determining the value assigned to each key assumption, must be provided in sufficient detail. These include assumptions on the duration and intensity of effects of the suspension of activities and of the recovery phase. Key assumptions used in performing impairment tests are likely to represent a source of significant estimation uncertainty and therefore the information required by IAS 36 may need to be supplemented by the information required by IAS 1:125-133, such as a sensitivity analysis.

Valuation of inventories

The COVID-19 pandemic may affect the recoverability of inventory balances. Some entities with inventories that are seasonal or are subject to expiration may have to assess whether a write-down for obsolescence or slow-moving stock may be necessary at an interim or annual period as a result of a slower sales pace. Other entities may have to assess whether a decline in their future estimated selling price is expected, which may require a write-down in the cost of inventory in an interim or annual period.

Applying IAS 2 *Inventories*, inventories are measured at the lower of their cost and net realisable value (NRV). NRV is an entity-specific measurement defined as "the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale". As a result of the pandemic, the NRV of an item of inventory may fall below its cost for many reasons, including a decline in selling prices (e.g. as a result of price concessions offered to customers), or an increase in the estimate of costs to complete and market the inventories (e.g. increased costs to provide protection to employees). In a difficult economic environment, the NRV calculation may be more challenging and require more detailed methods or assumptions. Interim inventory impairment losses should be reflected in the interim period in which they occur, with subsequent recoveries recognised as gains in future periods.

In addition, manufacturing entities may have to reassess their practices for fixed overhead cost absorption if production volumes become abnormally low during the year as a result of plant closures or lower demand for their products. IAS 2 requires that variable production overhead costs should be allocated to each unit of production based on the **actual use** of the production facilities. It also calls for the allocation of fixed overhead costs to each unit of production based on the **normal capacity** of the production facilities. The COVID-19 pandemic may affect manufacturing entities in a number of ways (e.g. shortages of labour and materials or unplanned factory downtime) that, if sustained, may result in an abnormal reduction of an entity's production levels. In such circumstances, an entity should not increase the amount of fixed overhead costs allocated to each inventory item. Rather, the unallocated fixed overhead costs are recognised in profit or loss in the period in which they are incurred. If the entity presents an analysis of expenses by function, these costs are included as part of cost of sales.

Conversely, if an entity produces goods that are in high demand as a result of the pandemic (e.g. personal protection equipment), its production levels may be abnormally high. If this is the case, the entity will need to decrease the amount of fixed overhead allocated to each inventory item.

An entity will also need to consider whether certain costs incurred because of the pandemic can be capitalised. These may include additional storage costs due to delays in delivery of inventories or costs of repackaging to make goods available in a different market with higher demand. IAS 2:16 gives the following as examples of costs that should be excluded from the cost of inventories and recognised as expenses in the period in which they are incurred:

- abnormal amounts of wasted materials, labour, or other production costs;
- storage costs, unless those costs are necessary in the production process before a further production stage;
- administrative overheads that do not contribute to bringing inventories to their present location and condition; and
- selling costs.

Costs to obtain or fulfil a revenue contract and up-front payments to customers

An entity may have recognised costs to obtain or fulfil a contract as an asset in accordance with IFRS 15 *Revenue from Contracts with Customers*. IFRS 15 provides guidance on determining the appropriate amortisation period and on recognising any impairment loss on such an asset. An entity may need to update its amortisation approach to reflect any significant changes in the expected timing of the transfer of the related goods or services. In addition, an entity must recognise an impairment loss if the carrying amount of the asset exceeds (1) the sum of the amount of consideration expected to be received and the amount of consideration already received but not yet recognised as revenue, less (2) the costs that are directly related to providing the remaining promised goods or services under the contract that have not been recognised as expenses. The consideration determined in (1) above should be adjusted to account for the customer's credit risk, and the amounts determined under both (1) and (2) should include the effects of expected contract renewals from the same customer. An entity may also need to consider whether contract modifications or changes in expectations regarding customer renewals affect the amortisation or recoverability of these revenue-related costs.

An entity may also have recognised up-front payments to customers as an asset that are reflected as a reduction in the transaction price. If so, it would be reasonable for the entity to perform similar analyses for any asset recognised for such up-front payments.

Further, an entity should evaluate contract assets for impairment by using the same model as customer receivables. See Financial Instruments for more information.

Financial Instruments

Allowance for expected credit losses (ECL)

COVID-19 can affect the ability of borrowers, whether corporate or individuals, to meet their obligations under loan relationships. Individual and corporate borrowers may have a particular exposure to the economic impacts in their geography and industry sector. More broadly, reductions in forecasts in economic growth increase the probability of default across many borrowers and loss rates may increase due to the fall in value of collateral evident more generally by falls in prices of assets.

Applying IFRS 9 *Financial Instruments*, an entity should measure ECL in a way that reflects:

- an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
- the time value of money; and
- reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

The impact of COVID-19 on ECL will be particularly challenging and significant for banks and other lending businesses. The effect could also be significant for non-financial corporates. This is because ECL does not only apply to loans but also applies to many investments in interest bearing financial assets (e.g. bonds and debentures), trade receivables, contract assets, lease receivables, issued loan commitments and issued financial guarantee contracts. The extent of these exposures in non-financial corporates may also be greater in individual company financial statements due to intra-group transactions such as intra-group loans or guarantees provided by the reporting entity on other entities' debt obligations.

Under the general model for impairment ECL is recognised for 12-month ECL or lifetime ECL dependent on whether there has been a significant increase in credit risk ("SICR") of a financial asset (or other exposure) since initial recognition (a "staging" analysis). This analysis 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 of the eventual impact of COVID-19. Despite the challenges, entities are still required to make estimates based on reasonable and supportable information that is available without undue cost or effort at the reporting date. Sources of such information can include information used in the entity's ongoing credit evaluation processes and financial forecasts for economies or industries that are becoming available over time. It is not expected that the difficulties associated with making estimates and assumptions in these uncertain times would be a basis for entities not to update ECL measurements.

Trade receivables

For entities with certain financial assets such as short-term trade receivables and contract assets the complexity of the estimate of ECL is reduced due to the application of the simplified approach. Under this approach there is no requirement for a complex staging analysis to be performed as lifetime ECL is recognised from the date of initial recognition. However, measurement of lifetime ECL follows the same principles as under the general model.

In practice the measurement of ECL for portfolios of trade receivables does not usually require complex analysis. The average historical credit losses on a large group of trade receivables with shared risk characteristics may until now have been a reasonable estimate of the probability-weighted expected loss amount. A common example of a loss rate approach used for trade receivables is a provision matrix developed using historical credit loss experience. IFRS 9 requires that historical loss rates are adjusted as appropriate to reflect current conditions and estimates of future economic conditions. However, until now such adjustments may have been limited.

COVID-19 will require entities to revisit the provision matrix approach and consider the following:

- The amount and timing of the expected credit losses as well as the probability assigned to alternative scenarios must be based on reasonable and supportable information that is available without undue cost or effort at the reporting date without the use of hindsight. Entities will need to reconsider their previous credit loss expectations if these are based on unadjusted historical experience that is not reflective of the current market conditions and forward looking information. In many cases, this may require significant judgement given the uncertainties present (e.g. financial viability of debtors, levels of government support, etc.).

- There may be a lack of relevant historical data reflecting sufficiently adverse economic conditions on which to base the estimate. An entity may already be observing the default of debtors and will need to determine the impact that these observations have on expectations of recoveries and future default of other debtors.
- Operational disruption experienced by both customers and suppliers as well as moratoriums on debt repayments or enforcement actions may result in delays in the processing and settlement of transactions. Short-term trade receivables are recognised at their transaction price and consequently have an effective interest rate (EIR) of nil, and therefore a delay in collection will not result in an increase in the reported loss allowance (measured by discounting expected shortfalls at the asset's EIR). However, these delays introduce uncertainty as to whether the full amount will be recovered and this uncertainty is required to be reflected in the ECL measurement. In some cases the delays may be considered temporary. This may mean that previously determined loss rates for the individual "days-past-due" categories included in an entity's provision matrix may not be reflective of expected recoveries.
- Greater volatility in potential economic conditions, even over the relatively short exposure period of trade receivables, will increase the importance of considering multiple economic scenarios in determining expected loss rates.
- With greater incidence of individual receivables in default, loss rates may need to be applied to individual receivables or sub-portfolios of receivables if the receivables in the overall portfolio no longer exhibit similar credit risk characteristics. This may result in a requirement to apply the provision matrix at a more granular level or to assess a greater number of receivables on an individual basis. Entities should ensure that any estimate of ECL on an individual debtor reflects a probability-weighted outcome and that an appropriate loss allowance continues to be recorded on a collective basis for all receivables that are not assessed individually.

The above considerations also apply to contract assets.

Other receivables

Although a staging analysis may not be required for trade receivables and contract assets, most entities will have some financial assets that are accounted for under the general model rather than the simplified model for which a staging analysis will be needed. For example, intercompany receivables, lending balances with entities outside the group and receivables relating to business disposals. The impact of forward-looking information and multiple economic scenarios is also likely to be more significant for such assets.

Low probabilities of default may have meant in the past that ECL for these has not been material. This may no longer be the case given the increased weighting to negative economic scenarios and exposures to specific industry sectors or geographical areas that are most significantly affected by COVID-19. Entities will therefore need to reconsider the appropriateness of past methods for assessing ECL and ensure up to date inputs are used.

Credit Enhancements

Credit enhancements may become increasingly prevalent, particularly as a result of various central government and central bank programmes designed to support debtors and/or creditors. Such schemes should be carefully analysed to assess whether they affect the measurement of ECL. Only credit enhancements integral to the receivable and that are not separately recognised should be reflected in the measurement of the ECL. Amounts receivable from non-integral credit enhancements are not included in ECL measurement and are recognised separately.

Support of the economy in general or that is expected to be given directly to a debtor to assist them with repaying the amounts owed does not represent a credit enhancement but could nevertheless affect the ECL measurement (e.g. through reduced probability of default or reduced loss given default).

Issued financial guarantee contracts

Parent entities sometimes issue financial guarantee contracts (FGC) to lenders of their subsidiaries, associates or joint ventures that allow the lender to claim any losses suffered due to non-payment of those entities. These parent entities are required to recognise a liability for the issued FGC for the higher of the unamortised premium and the ECL determined in accordance with IFRS 9. When COVID-19 results in a higher risk of default this will lead to increased ECL amounts.

Fair value measurements

Fair value measurements of financial instruments should reflect market participant views and market data at the measurement date under current market conditions. Observable market data cannot be ignored even if depressed prices are considered temporary. Entities will need to pay particular attention to fair value measurements based on unobservable inputs (sometimes referred to as level 3 measurements) and ensure that the unobservable inputs used reflect how market participants would reflect the effect of COVID-19, if any, in their expectations of future cash flows, discount rates and other significant valuation inputs related to the asset or liability at the reporting date.

Liquidity risk management

Disruptions in production and reduced sales can have implications on an entity's working capital and could lead to a breach of a debt covenant resulting in the liability becoming current.

Entities may look for ways to manage this risk, including the use of alternative sources of funding, such as later payment to suppliers and arrangements with financial institutions such as supplier finance and reverse factoring which may permit the entity to draw down on finance in exchange for the financial institution paying the entity's suppliers. When entities have previously determined that liabilities to banks in these scenarios are presented as trade or other creditors rather than as borrowings, any increase in the repayment term will require a reassessment of the classification to ensure it remains appropriate. Disclosure of these facilities will be critical particularly when they are material to the entity's funding or viability.

Entities may also seek to obtain early settlement of their trade receivables via a financial institution buying the receivables at a discounted amount to the invoice amount. Such transactions should be carefully assessed to determine if derecognition of the factored receivables is appropriate.

Concentration risk may be particularly significant to some entities when customers are concentrated in an adversely affected industry such as the hospitality and tourism and airline industries. Such entities will need to give clear disclosure of the potential impact on liquidity if significant.

Entities should consider how the use of working capital enhancement or management techniques is reflected in the entity's disclosure of its liquidity risk management as required by IFRS 7 *Financial Instruments: Disclosures*. Entities should also consider the specific disclosure requirements for transfers of financial assets as required by IFRS 7 when financial assets are sold to fund working capital needs, and the accounting policies and judgements applied in determining the balance sheet and cash flow statement presentation of amounts due and paid when supplier finance and reverse factoring arrangements are used. For example, entities should consider providing sufficiently detailed quantitative and qualitative disclosures about:

- their access to cash and sources of finance (including reverse factoring arrangements);
- any changes or likely changes to the existing financing arrangements;
- any new arrangements entered into;
- credit gradings and any changes which impact cost or access to funding (e.g. if the grading falls below investment grade); and
- any developments subsequent to the reporting date.

Entities that rely on the extended financing terms provided by reverse factoring arrangements to manage liquidity risk through the option to pay the financial institution later than it would have paid the supplier(s), will need to ensure that the impact of these programmes is properly disclosed. Indeed, if a financial institution were to withdraw the arrangement this could adversely affect the entity's ability to settle liabilities, particularly if the entity were already in financial difficulties.

If relevant, entities should explain the impact of government assistance programmes as part of their liquidity risk management. For example, disclosures may include how much funding is available, the likelihood that the funding will be utilised and the time horizon over which the funds are available.

Entities may also need to reconsider the existing classification of certain investments as cash equivalents under IAS 7 *Statement of Cash Flows*. To be classified as a cash equivalent, an investment, for example in a money market fund, must be held for the purpose of meeting short-term cash commitments and must be readily convertible to known amounts of cash and subject to insignificant changes in value. Current economic conditions are likely to increase the volatility in prices of many investments and reduce their liquidity.

Dividends and capital management

IAS 1 requires an entity to disclose information regarding its objectives, policies and processes for managing capital. Disclosures of changes made to capital management in response to COVID-19 will be relevant for many entities.

Entities operating in jurisdictions where distributable profits are established on the basis of profits determined in accordance with IFRS Standards, will need to consider how the effect of the COVID-19 pandemic on their financial statements may affect their ability to declare dividends.

Where the distribution of dividends has been suspended, it is helpful to indicate when the period of suspension is expected to end or the decision revised.

Classification of financial assets

Some entities may decide to sell receivables as part of their strategy to manage their credit and liquidity risks. Where such receivables are treated as "held to collect" and measured at amortised cost an increase in frequency and value of sales may result in the need to consider whether there has been a change in the entity's business model or whether a new business model has been initiated.

Entities should analyse any increase in sales to determine, among other things, whether the increase is expected to persist (for example if the sales are in response to temporary increases in credit or liquidity risk) or whether future sales volumes will be lower in frequency or value. Irrespective of their frequency and value, sales due to an increase in the assets' credit risk are not normally considered to be inconsistent with a held to collect business model because the credit quality of financial assets is relevant to the entity's ability to collect contractual cash flows. Credit risk management activities that are aimed at minimising potential credit losses due to credit deterioration are integral to such a business model.

Some entities that have assets that are held under a "held to collect and sell" or "held to sell" business model may find that previously anticipated sales are no longer expected to take place due to a reduction in asset values or in the liquidity of the relevant market. IFRS 9:B4.4.3 states that neither a change in intention related to a particular asset (even in circumstances of significant changes in market conditions), nor a temporary disappearance of a particular market represent a change in an entity's business model.

Reclassifications triggered by a change in business model are expected to be highly infrequent and to incur only when the activity is significant to the entity's operations; they are applied prospectively from the reclassification date.

Debt modifications

In response to liquidity challenges, an entity's debtors may seek to renegotiate the terms of their arrangements with the entity. Where the entity grants such concessions and modifies the related contractual arrangements, the accounting impact of the modification must be assessed. Similarly, a reporting entity may itself experience liquidity or solvency challenges and seek to renegotiate terms of its borrowings or other liabilities resulting in amendments to existing agreements (either amendments to the cash flows or related covenants).

In respect of financial liabilities the entity must consider whether the modifications are substantial which typically involves qualitative factors as well as an assessment of whether the modifications result in a change in the net present value of the instrument's cash flows of more than 10 per cent (the "10 per cent test"). When a modification is substantial the existing financial liability is derecognised and the new liability is recognised at fair value resulting in a gain or loss. It is particularly important to note, however, that an adjustment to the carrying value will result even when the modification is not substantial (determined by discounting the revised cash flows at the original EIR).

Although IFRS 9 includes no specific guidance on accounting for modifications of financial assets and when they should result in derecognition, some entities have an accounting policy of applying the 10 per cent test to financial assets and accounting for a substantial modification as the extinguishment of the old asset and recognition of a new asset.

IFRS 9:5.5.12 provides specific guidance on how to apply the impairment requirements to scenarios when a modification of a financial asset does not lead to derecognition.

When intragroup funding arrangements are modified, consideration should be given to the identification of intergroup capital contributions or distributions. Entities should determine whether there has been impairment of a financial asset in advance of its modification. Thereafter, the difference between the carrying amount of the financial instrument derecognised and the fair value of the new financial instrument recognised may need to be allocated between a derecognition gain or loss and a capital contribution or distribution between parties under common control.

Changes in estimated cash flows

COVID-19 may result in a change in expectations regarding the exercise of prepayment, extension or conversion features in debt agreements. When such features are accounted for as bifurcated embedded derivatives or when the entire instrument is measured at fair value through profit or loss (FVTPL), changes in the likelihood of those features being exercised will be reflected in the fair valuation. When such features are accounted for as part of a host debt instrument that is measured at amortised cost, remeasurement adjustments recognised in profit or loss may still arise as the revised expected cash flows are discounted at the instrument's original effective interest rate. When a conversion feature is classified as equity, changes in expectations regarding its exercise would have no impact on the amount originally recorded in equity.

Hedge accounting

When a transaction has been designated as the hedged item in a cash flow hedge relationship the entity will need to consider whether the transaction is still a "highly probable forecasted transaction" and if not, whether it is still expected to occur. Hedged items in a cash flow hedge that could be affected due to COVID-19 include:

- Sale or purchase volumes that fall below the levels originally forecasted;
- Planned debt issuances that are delayed or cancelled such that interest payments fall below levels originally forecasted; and
- Business acquisitions or disposals that are delayed or cancelled.

If an entity determines that a forecasted transaction is no longer highly probable, but still expected to occur, the entity must discontinue hedge accounting prospectively and defer the gain or loss on the hedging instrument that has been recognised in other comprehensive income accumulated in equity until the forecasted transaction occurs. If the forecasted transaction is no longer expected to occur the entity must immediately reclassify to profit or loss any accumulated gain or loss on the hedging instrument.

When the expected timing of a designated hedged transaction changes, an entity is required to reassess whether the hedged transaction identified in the entity's hedge documentation is still the same hedged transaction (i.e. assess whether the hedged transaction is still expected to occur).

A change in the timing of a hedged forecast transaction when its occurrence remains highly probable may also have an effect on profit or loss. Hedge ineffectiveness can exist because a difference arises in the amount and/or timing of the hedged item and the hedging instrument. It is common for entities to determine a 'hypothetical derivative' to reflect the timing and amount of the hedged item and use the fair valuation of this to compare with the hedging instrument to determine the amount of hedge ineffectiveness to be recognised in profit or loss. As the timing and/or amount of the hedged item changes in response to economic conditions, entities should redefine the hypothetical derivative to ensure hedge ineffectiveness is appropriately recognised.

Finally, increases in credit risk may cause a hedge relationship to fail its hedge effectiveness assessment if credit risk dominates the value changes resulting from the economic relationship between the hedging instrument and the hedged item.

Contracts to buy/sell commodities

IAS 32 *Financial Instruments: Presentation*, IFRS 7 and IFRS 9 deal primarily with contracts that are financial items; however, they also capture some contracts to buy or sell non-financial items. Contracts to buy or sell non-financial items that can be settled net (either in cash or by exchanging financial instruments) are within the scope of IAS 32, IFRS 7 and IFRS 9 unless they were entered into, and continue to be held, for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements (i.e. are held for 'own use').

The significant disruption to supply and demand may result in net cash settlement of contracts to buy or sell commodities or other non-financial assets that were previously expected to be physically settled and were accounted for as 'own use' contracts (i.e. outside the scope of IFRS 9). The assessment of whether a non-financial contract is held for 'own use' is a continuous assessment and is not only performed at inception of the contract. Consequently, the expected net cash settlement of contracts to buy or sell non-financial items (e.g. commodities) will bring those contracts within the scope of IFRS 9 and result in classification of the contracts as financial assets or liabilities subject to the measurement requirements of that Standard. Under IFRS 9, commodity derivatives not designated in hedging relationships are accounted for at FVTPL.

When assessing whether contracts to buy or sell commodities are for own use, it will be necessary to identify the contract to which the assessment applies. Each contract must be evaluated in its entirety. For example, an entity may have a contract for 100 units, but its expected usage requirement is only 80 units. The entity intends to net settle the part of the contract it does not need in its normal course of business. Such partial net settlement can be achieved in different ways (e.g. by entering into an offsetting contract for 20 units, or by taking delivery of all 100 units and selling 20 immediately). The entire contract falls within the scope of IFRS 9 because the entire contract cannot be argued to be in accordance with the entity's expected usage requirements.

Net settlement of a non-financial contract would only cause other similar contracts to fail the own use requirements if it establishes a past practice of net settlement. It is a matter of judgement as to what is past practice of net settlement. An entity will need to consider its historical behaviour, the reasons for past net settlement, and the relative frequency. Depending on the specific circumstances, it may be argued that an occurrence of a net settlement in the past was the result of an isolated non-recurring event that could not have been reasonably anticipated.

Entities sometimes enter into transactions where cash is prepaid for the supply of non-financial items (e.g. for commodities such as oil). In certain circumstances, for the payer of the prepayment, this may result in the recognition of a non-financial asset because it expects to receive the non-financial item and it meets the own use requirements in IFRS 9. Likewise, the receiver of the cash may recognise a non-financial liability because it expects to deliver the non-financial item and it meets the own use requirements in IFRS 9. Expected cash settlement of such contracts would result in them being treated as a financial instrument in the scope of IFRS 9 and classified as a financial asset or financial liability.

Revenue from contracts with customers

Business disruptions associated with the COVID-19 pandemic may prevent an entity from entering into customer agreements by using its normal business practices, which may make the determination of whether it has enforceable rights and obligations challenging. In addition, because many of its customers are 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 (e.g. 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 (1) revise its agreements to reduce any purchase commitments; (2) allow customers to terminate agreements without penalty; or (3) provide price concessions, discounts on the purchase of future goods or services, 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 (1) request up-front payments from its customers; (2) delay the delivery of goods or services; (3) pay penalties or refunds for failing to perform, not meeting service-level agreements, or terminating agreements; or (4) incur unexpected costs to fulfil its performance obligations. Therefore, as a result of the changes in circumstances experienced by both an entity and its customers due to the COVID-19 pandemic, an entity may need to consider the following when assessing revenue from contracts with customers:

- *Contract enforceability*—IFRS 15:9 provides criteria that need to be met to account for a contract with a customer, including the approval of the parties to the contract and a commitment to perform their respective obligations. If the criteria are not met, no revenue can be recognised until one of the following occurs: (1) the criteria are met; (2) no obligations to transfer goods or services remain and substantially all of the consideration promised by the customer has been received and is non-refundable; (3) the contract has been terminated and the consideration received is non-refundable.

  In certain circumstances, the parties may not be able to approve a contract under an entity's normal and customary business practices. For example, the entity may not be able to obtain the signatures it normally obtains when entering into a contract because personnel from the entity or customer are unavailable or otherwise unable to provide signatures. Therefore, it is important to carefully evaluate whether the approval process creates a contract with enforceable rights and obligations between the entity and its customer. In making this determination, an entity may consider consulting with its legal counsel. If enforceable rights and obligations do not exist, revenue cannot be recognised until certain conditions are met (see above paragraph).

  The effect of a "force majeure" clause allowing the parties to terminate a contract without incurring penalties in certain extraordinary circumstances will also need to be considered.

- *Collectability*—A contract with a customer does not exist unless it is probable that the entity will collect substantially all the consideration to which it will be entitled in exchange for the promised goods or services that will be transferred. The collectability of that consideration should be assessed after taking into account expected price concessions (including implied concessions), which are evaluated as variable consideration, even if those concessions are provided as a result of credit risk. In addition, whilst the collectability analysis is performed at the individual contract level, an entity may look to a portfolio of similar contracts (e.g. by risk profile, size of customer, industry, geography, etc.) in its assessment. For example, if it is probable that an entity will collect substantially all the consideration for 90 per cent of a portfolio of similar contracts, and the entity is unable to identify specific contracts for which consideration is unlikely to be collected (i.e. the risk is the same for all contracts), the entity may conclude that it has met the collectability threshold for all the contracts in the portfolio. However, an entity should not ignore evidence related to specific contracts that do not meet the collectability criterion. In that circumstance, it should evaluate those specific contracts separately. Further, in determining what are similar contracts under a portfolio approach, an entity may need to consider disaggregating its contracts at a more granular level than it has in the past. For example, an entity may not have historically disaggregated its contracts by industry but may reconsider its disaggregation on the basis that some industries may be more heavily affected than others (e.g. hospitality, travel).

An entity should not reassess whether a contract meets the criteria in IFRS 15:9 after contract inception unless there has been a significant change in facts and circumstances. If the impacts of the COVID-19 pandemic result in a significant deterioration of a customer's or a portfolio of customers' ability to pay, the entity should reassess collectability. For example, if a customer experiences liquidity issues or a downgrade in its credit rating, the entity would need to carefully evaluate whether those circumstances are short-term in nature or result in a determination that it is no longer probable that the customer has the ability to pay. Because of the significant uncertainty associated with the effects of the pandemic, it is important for the entity to document the judgements it made and the data or factors it considered. For example, the entity may determine that certain customers that are in financial distress will improve their liquidity position with government assistance. If the entity concludes that collectability is not probable, a customer contract no longer exists and, thus, the entity can no longer recognise revenue under IFRS 15's 5-step model. If collectability becomes probable in a subsequent period and the other criteria in IFRS 15 are met, the entity can begin to recognise revenue again. See the discussion on contract enforceability above for conditions that need to be met to recognise revenue when an enforceable contract does not exist.

- *Contract modification*—An entity may modify its enforceable rights or obligations under a contract with a customer. For example, the entity may grant a price concession to a customer. In that circumstance, the entity should consider whether the concession is due to the resolution of variability that existed at contract inception (i.e. a change in transaction price associated with variable consideration) or a modification that changes the parties' rights and obligations. A price concession that is provided solely as a result of the COVID-19 pandemic most likely represents a modification that changes the parties' rights and obligations. Conversely, a price concession that had always been envisaged as possible and was therefore already being treated as variable consideration continue to be accounted as such even though it may be triggered by COVID-19 (see the discussion on variable consideration below).

  In addition, an entity may modify the scope of a contract (e.g. by reducing minimum purchase commitments). If the modification adds goods or services to the contract for an incremental fee, the entity should first evaluate whether the modification is accounted for as a separate contract in accordance with IFRS 15:20. Such a modification is a separate contract if the added goods or services are priced at their stand-alone selling prices, which may be adjusted to reflect the circumstances of the contract (e.g. a discount due to the lack of additional selling costs). In making this determination, an entity should consider whether the stand-alone selling price of its goods or services have changed in light of the current economic environment. Any changes in the stand-alone selling price of goods or services do not affect prior contracts unless those contracts have been modified.

  However, if the only change to a contract is a reduction of the transaction price or the modification is not otherwise a separate contract applying IFRS 15:20, the entity should evaluate the guidance in IFRS 15:21 to determine whether the modification should be accounted for as (1) a termination of the old contract and the creation of a new contract because the remaining goods or services are distinct (which results in prospective treatment); (2) a cumulative catch-up adjustment to the original contract because the remaining goods or services are not distinct; or (3) a combination of (1) and (2). If all performance obligations have been satisfied, any price concession would be treated as a change in transaction price in accordance with IFRS 15:87-89.

- *Variable consideration*—Variable consideration includes, among other things, rebates, discounts, refunds (including for product returns), price concessions and penalties. In accordance with IFRS 15:56, an entity should only include amounts of variable consideration in the transaction price if (or to the extent that) it is highly probable that doing so would not result in a significant reversal of cumulative revenue recognised when the uncertainty related to the variable consideration is resolved. Further, an entity must update its estimated transaction price in each reporting period. The entity may need to consider any expected changes in (1) its ability to perform; and (2) customer behaviour that results from deteriorating economic conditions. For example, an entity may need to consider updating its estimated transaction price if it expects an increase in product returns, decreased usage of its goods or services or decreased royalties, increased invocation of retrospective price protection clauses, changes in redemption rates of coupons or volume rebates, or to potentially pay contractual penalties or liquidating damages associated with its inability to perform (e.g. the inability to deliver goods or services on a timely basis or to meet service-level agreements). In certain circumstances, an entity's estimate of penalties or liquidated damages could be limited by force majeure clauses. Further, an entity may need to reconsider whether it will be able to achieve milestone payments, performance bonuses, trailing commissions based on renewals, or other performance-related fees.

If there is a reduction in the estimated transaction price, a change in estimate may result in the reversal of revenue for amounts previously recognised as variable consideration (e.g. as a result of an increase in return reserves).

An entity may need to allocate a reduction in the estimated transaction price to all performance obligations in a contract unless the change in estimated variable consideration is related to only one or more (but not all) performance obligations (or distinct goods or services) in accordance with IFRS 15:85, 86 and 89 (e.g. penalties for late deliveries may be associated with only some of the goods or services in a contract). In addition, an entity may not need to recognise a reduction in the estimated transaction price when applying the variable consideration constraint if the reduction is too small to result in a significant reversal of cumulative revenue recognised. Because of the significant uncertainty associated with the pandemic's effects on an entity and its customers, it may be challenging for the entity to make appropriate estimates of variable consideration. Therefore, in a manner similar to its assessment of contract collectability, an entity must document the judgements it made and the data or factors it considered, and ensure it has carefully considered how to constrain estimates of variable consideration.

Further, an entity may have a right to receive non-cash consideration (e.g. shares) from a customer that has declined in value. If the entity's accounting policy is to measure non-cash consideration at its estimated fair value at contract inception, any changes in the fair value of non-cash consideration after contract inception that are solely due to a decrease in value are not variable consideration and would not be reflected in the transaction price. Rather, the non-cash consideration should be accounted for under the applicable IFRS Standard.

Additionally, when it is possible that future penalties will be triggered under a contract (e.g. as a result of the late delivery of a good or service), these will reduce the estimate of the transaction price to be allocated between performance obligations, other than in cases where it is highly probable that the penalties will not arise, or where they are too small to result in a significant reversal of revenue. When a reduction to the transaction price is required, it will be important to consider the guidance in IFRS to determine whether that variable consideration should be allocated to specific performance obligations (e.g. the particular deliveries that are expected to be late) or to all performance obligations.

- *Material right*—To mitigate any decline in sales, an entity may offer its customers sales incentives, including discounts on future goods or services. In this circumstance, the entity should evaluate whether a sales incentive on the purchase of future goods or services represents (1) a material right in accordance with IFRS 15:B40 that is associated with a current revenue contract (whether explicit or implicit because there is a reasonable expectation on the part of a customer that he or she will receive a sales incentive at contract inception); or (2) a discount that is recognised in the future upon redemption (i.e. when revenue is recognised for the related goods or services) in a manner consistent with IFRS 15:72.

  In addition, for new or modified contracts, an entity may need to update its estimates of the stand-alone selling price of a material right (e.g. because the entity extended the periods for use or provided additional incentives to a customer) or to reassess its breakage assumptions (e.g. because of extensions or changes in expected usage patterns). For example, an entity may modify its loyalty programme by extending customers' ability to use points; this change may require the entity to reassess the breakage assumptions it uses.

- *Significant financing component*—To assist customers that are experiencing liquidity issues in purchasing goods and services, an entity may provide extended payment terms. Similarly, an entity with liquidity issues may require its customers to make an up-front payment in order for the entity to fulfil its promised goods or services. In those circumstances, an entity should evaluate whether a significant financing component exists in accordance with IFRS 15:60-65. If an entity modifies payments terms for an existing customer contract, it should consider the guidance on price concessions discussed above. In addition, while the extension of payment terms does not in and of itself indicate that a contract is not collectible, an entity may need to consider its procedures for assessing collectability as noted in the Collectability discussion above.

- *Implied performance obligations*—An entity may assist its customers by providing them with free goods or services that are not explicitly promised in the contract. In a manner consistent with IFRS 15:24, an entity should determine whether its contracts with customers contain promised goods or services that are implied by its customary business practices or published policies or by specific statements that create a reasonable expectation of the customer that the entity will transfer those goods or services.

There may also be instances in which an entity provides free goods or services to its customer that are not part of a prior contract with that customer (i.e. when the prior contract was entered into, there were no explicit or implicit obligations to provide those goods or services). An entity must carefully evaluate whether the additional promised goods or services are a modification of a pre-existing customer contract or a cost incurred that is separate from any pre-existing contracts. In these situations, it may be helpful to consider the contract combination guidance in IFRS 15:17, which specifies that contracts with the same customer (or related party of the customer) are combined, if (1) they are negotiated as a package with a single commercial objective; (2) the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or (3) there are goods or services in one contract that would be a single performance obligation when combined with the goods or services in another contract. In addition, an entity should consider the substance of the arrangement to provide the free goods or services and whether accounting for the arrangement as a separate transaction or as a contract modification would faithfully depict the recognition of revenue related to the goods or services promised to the customer in a pre-existing contract.

In many cases, free goods or services provided to a customer solely as a result of the COVID-19 pandemic (that are not part of another newly entered contract with that customer) will not be considered a contract modification, in particular if they are broad-based and not negotiated with the customer (e.g. an internet service provider increasing monthly data allowances without additional charge for all customers for a three-month period to support working from home and homeschooling activities). However, an entity may need to determine whether it has developed a practice that creates an implied promise in future contracts.

- *Recognition of revenue*—Because of potential supply disruptions or other circumstances, an entity may need to reconsider the timing of revenue recognition if it is unable to satisfy its performance obligations on a timely basis. Revenue cannot be recognised until control of the goods or services transfers to the customer (i.e. when the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the goods or services). For example, an entity may not be able to fulfil its stand-ready obligation due to government-mandated shutdowns (e.g. the temporary shutdown of a health club). In that circumstance, the entity may need to cease recognising revenue until it is able to perform. In addition, the entity must determine whether there are any contractual penalties that would affect the transaction price. In some cases, an entity may be completely unable to satisfy its performance obligation, which could result in (1) the termination of the contract, (2) a reversal of any revenue it previously recognised for a performance obligation that was not fully satisfied, and (3) the recognition of a refund liability (or additional liability due to a payment of penalties) instead of deferred revenue.

  Sometimes, delays in the transfer of goods or services may be caused by the customer or other external factors. For example, a customer may not be able to obtain physical possession of a product because of shipping delays or because it cannot receive the product (e.g. warehouse personnel may be unavailable). In such cases, an entity should carefully consider when control of the product transfers (e.g. before or after shipment). Further, if a customer is unable to take physical possession of the product, it may request that the entity retain the product on a bill-and-hold basis. In this circumstance, the entity would need to consider the bill-and-hold guidance in IFRS 15:B79-B82.

  An entity may also incur unexpected costs in fulfilling a performance obligation that is satisfied over time. If the entity is using costs incurred to date as an input method to measure progress towards complete satisfaction of its performance obligation, it should be careful to ensure that revenue attributed to work carried out is not increased to offset additional costs incurred when abnormal or excessive costs arise as a result of inefficiency or error. In particular, IFRS 15:B19(a) states that, when using a cost-based input method, entities may be required to adjust the measure of progress when costs are incurred that are "attributable to significant inefficiencies in the entity's performance that were not reflected in the price of the contract".

- *Disclosure requirements*—Many of the circumstances described above could affect an entity's disclosures. These include, but are not limited to, disclosures of significant changes in the contract asset due to an impairment, significant payment terms (including any significant financing component), and the timing of when an entity expects to recognise revenue for its remaining performance obligations (which would exclude terminated contracts or transactions that do not meet the criteria in IFRS 15:9 to be accounted for as a customer contract). Given the level of uncertainty caused by the COVID-19 pandemic, an entity may find it challenging to make certain critical estimates. Therefore, it is important for the entity to disclose any significant judgements and estimates it makes in accounting for its revenue contracts (e.g. assessing collectability; estimating and constraining variable consideration; measuring obligations for returns, refunds, and other similar obligations; measuring progress toward completion of a performance obligation recognised over time; and determining the stand-alone selling prices and breakage assumptions for material rights).

Restructuring plans

In a difficult economic environment and facing difficulties in obtaining financing, an entity may be considering or implementing restructuring plans such as the sale or closure of part of its businesses or the downsizing (temporarily or permanently) of operations. Plans such as these may require consideration of a number of issues, including whether:

- the entity has a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it. If, and only if, both of these criteria are met a restructuring provision should be recognised; and
- any part of the business is available for immediate sale in its present condition and completion of such a sale within one year is highly probable. If so, the assets and liabilities to be disposed of are classified as held for sale applying IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and written down to their fair value less costs to sell if this is lower than their carrying amount.

Onerous contracts provisions

At the inception of an executory contract, both parties to the contract expect to receive benefits that are equal to or greater than the costs to be incurred under the contract. Because of the impacts of COVID-19, unavoidable costs of meeting the obligations under the contract may exceed the benefits expected to be received, resulting in an onerous contract. IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* requires recognition of a provision in respect of an onerous contract.

Examples of contracts for which an onerous contract provision may be required include:

- Increased costs of fulfilling a customer contract due, for example, to the replacement of staff who are infected, subject to quarantine or are otherwise restricted from travel; or having to purchase alternative raw materials at a higher price due to supply chain issues; and
- Lease contracts prior to the commencement date.

The provision recognised for an onerous contract should reflect the least net cost of exiting from the contract, i.e. the lower of:

- The cost of fulfilling the contract; and
- Any compensation or penalties arising from failure to fulfil the contract.

When assets dedicated to a contract are involved, however, a separate provision is recognised only after any impairment loss has been recognised in respect of those assets.

In determining the least net cost of exiting the contract, an entity should pay attention to terms of the contract that allow the entity to terminate the contract without incurring penalties in certain extraordinary circumstances (“force majeure”). If a contract includes such a force majeure provision that can be enacted by the COVID-19 pandemic, it may be that the contract is not onerous because the entity can avoid any further obligations.

Provisions should not be recognised in respect to:

- Penalties for failure to respect the terms of a revenue contract, such as a late delivery penalty that is incurred if goods are not supplied by a specified delivery date. Such penalties are accounted for under IFRS 15, because they are a form of variable consideration that affects revenue, so they are not within the scope of IAS 37. Even when a penalty has already been triggered, any associated liability would be accounted for under IFRS 15, and not as a provision under IAS 37 (see Variable Consideration in the Revenue from contracts with customers). However, if the contract has, as a whole, become onerous as a result of the penalty clause, a provision should be recognised for any net loss expected to result.
- Leases (other than short-term leases and leases of low value assets accounted for in accordance with paragraph 6 of IFRS 16 *Leases*) that become onerous after their commencement date: these leases are dealt with instead applying the general requirements of IFRS 16. For example, an entity will determine and recognise any impairment of ROU assets applying IAS 36. However, an onerous contract provision may need to be recognised for non-lease components that are accounted for separately.

- Future operating losses: IAS 37 sets out two prohibitions on the recognition of provisions for future operating losses:
  - A general prohibition, on the grounds that there is no present obligation and thus no liability (albeit the expectation of future operating losses may indicate a need to test whether assets have been impaired).
  - A specific prohibition in respect of future operating losses up to the date of a restructuring (again on grounds that there is no present obligation, unless the losses relate to an onerous contract).

Insurance recoveries

Entities that incur losses stemming from the COVID-19 pandemic may be entitled to insurance recoveries. For example, losses associated with increased medical claims, asset impairments, or shareholder litigation may be considered insured losses by many entities. Furthermore, entities may have a business interruption insurance that provides coverage for lost profits due to a suspension of their operations. It may also be the case that an entity with a present obligation can seek reimbursement of part or all of the expenditure from another party, for example via an insurance contract arranged to cover a risk, an indemnity clause in a contract or a warranty provided by a supplier.

The basis underlying the recognition of a reimbursement is that any asset arising is separate from the related obligation. Consistent with the requirements of IAS 37 on contingent assets, such a reimbursement should be recognised only when it is virtually certain that it will be received if the entity settles the obligation.

Note that it is the existence of the reimbursement asset that must be virtually certain, rather than its amount. An entity may be virtually certain that it has insurance to cover a particular provision, but it may not be certain of the precise amount that would be received from the insurer. Provided that the range of possible recoveries is such that the entity can arrive at a reliable estimate, it will be able to recognise this as an asset, even though the amount ultimately received may be different.

However, a conclusion that potential insurance recovery is virtually certain will involve significant judgement and should be based on all relevant facts and circumstances. In determining whether the threshold for recognition of a reimbursement asset is met, an entity will most likely, among other factors, need to understand the solvency of the insurance carrier and have had enough dialogue and historical experience with the insurer related to the type of claim in question to assess the likelihood of payment. Other potential challenges an entity may encounter when evaluating whether a loss is considered recoverable through insurance include, but are not limited to, (1) the need to consider whether losses stemming from a pandemic are specifically excluded as a covered event; (2) the extent of coverage and limits, including multiple layers of insurance from different carriers; and (3) the extent, if any, to which the insurance carrier disputes coverage. Consultation with legal counsel may also be necessary.

When a reimbursement asset is recognised, its presentation is as follows:

- In the statement of financial position, a separate asset is recognised (which must not exceed the amount of the provision).
- In profit or loss, a net amount may be presented, being the anticipated cost of the obligation less the reimbursement.

Lease contracts

As a result of the COVID-19 pandemic, certain entities are experiencing significantly reduced consumer traffic in retail stores and shopping areas, or indefinite closures due to quarantine measures and other government directives.

Impairments to right-of use (ROU) assets could occur as a result of business closures, supply chain disruption, or other consequences of the pandemic that negatively affect the future cash flows expected to be derived from the use of the underlying asset. ROU assets measured applying a cost model are carried at cost less any accumulated depreciation and any impairment losses (and adjusted for specific remeasurement of the lease liability). Impairment is assessed applying the requirements in IAS 36 discussed above.

Lessees in some affected markets are receiving rent abatements or other economic incentives.

Generally, the accounting treatment for lease rent concessions will depend on whether (1) the lessee was entitled to the economic relief (i.e. the contractual arrangement or jurisdictional laws provide an enforceable right) or (2) the relief was given or negotiated outside the original agreement. In determining whether the lease contained an entitlement to relief, an entity should consider contractual provisions governing the occurrence of extraordinary events (e.g. a force majeure clause or similar provision). Depending on the complexity of the arrangement and the legal framework in the applicable jurisdiction, the entity may need assistance from legal counsel.

Economic relief that was given or negotiated outside the original agreement most likely represents a lease modification, in which case the lessee applies the requirements in IFRS 16:44-46 and the lessor applies the requirements in IFRS 16:79-80 if the lease being modified is a finance lease and in IFRS 16:88 if it is an operating lease.

For the lessee, this means that if the economic relief affects only the lease payments but does not change the scope of the lease (i.e. there is no change in the assets leased or in the duration of the lease term), the lease liability would be remeasured by discounting the revised lease payments using a revised discount rate, and a corresponding adjustment would be made to the right of use asset.

Economic stimulus measures put in place to address the financial consequences of the COVID-19 pandemic have led to a lower interest rate environment across many jurisdictions, which may result in bigger lease liabilities having to be recognised following lease modifications. The impact of the decrease in discount rate will be particularly pronounced for those who on transition to IFRS 16 adopted a full retrospective approach. The current economic conditions are likely to lead to the need to test the ROU asset for impairment and may indeed result in an impairment loss.

Furthermore, the operational challenges of reviewing potentially a multitude of leases across many jurisdictions with different concessions and reliefs should not be underestimated.

If the lessee was entitled to the economic relief because of either contractual or legal rights, the relief would be treated as variable rent (i.e. negative variable rent) in the period incurred. The lessee would then recognise variable lease payments in profit or loss when the associated variability or conditionality is resolved.

The above discussion addresses relief received from a lessor (either contractually or through negotiation). In some jurisdictions, tenant relief is provided by governments as subsidies in support of the economy. If the lessee receives the relief directly from the government, the tenant relief is accounted for as a government grant applying IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*. If the government relief is provided to the lessor who then passes it to the lessee, careful assessment is needed to establish whether the lessor is acting as an agent and the relief to the lessee is a government grant or whether the relief to the lessee is provided by the lessor and thus is a lease modification.

Amendment to IFRS 16 *Covid-19-Related Rent Concessions*

On 28 May 2020, the Board published an amendment to IFRS 16 adding a practical expedient which allows a lessee to elect not to assess whether a COVID-19-related rent concession is a lease modification. No practical expedient is available to lessors.

A lessee that makes this election accounts for any change in lease payments resulting from the COVID-19-related rent concession in the same way that it would account for the change if it were not a lease modification in accordance with IFRS 16.

The practical expedient applies only to rent concessions occurring as a direct consequence of COVID-19 and only if all of the following conditions are met:

- the change in lease payments results in revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change;
- any reduction in lease payments affects only payments originally due on or before 30 June 2021 (a rent concession would meet this condition if it results in reduced lease payments on or before 30 June 2021 and increased lease payments that extend beyond 30 June 2021); and
- there are no substantive changes to other terms and conditions of the lease.

A lessee that chooses to apply the practical expedient is required by IFRS 16:2 to apply it consistently to all lease contracts with similar characteristics and in similar circumstances.

Lessees that apply the exemption are required to disclose that they have applied the practical expedient to all rent concessions that meet the conditions, or, if not applied to all such rent concessions, information about the nature of the contracts to which they have applied the practical expedient. Lessees also have to disclose the amount recognised in profit or loss which reflects the changes in lease payments arising from rent concessions to which the lessee has applied the practical expedient.

The amendment is effective for annual reporting periods beginning on or after 1 June 2020. Earlier application is permitted, including in financial statements not yet authorised for issue at 28 May 2020.

Lessees are required to apply the amendment retrospectively, recognising any difference arising on initial application of the amendment in the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of the annual reporting period in which the lessee first applies the amendment.

Further information on the amendment is available in *IFRS in Focus* IASB finalises amendment to IFRS 16 *Leases* regarding COVID-19-related rent concessions.

Accounting for changes in lease payments applying the exemption

A lessee that applies the practical expedient would generally account for:

- The forgiveness or waiver of lease payments as a variable lease payment. The lessee would consequently derecognise that part of the lease liability that has been extinguished by the forgiveness of lease payments, and recognise a corresponding gain in profit or loss.
- A change in lease payments that reduces payments in one period but proportionally increases payments in another (such that there is no change to the overall consideration for the lease and only the timing of individual payments changes), by continuing to recognise interest on the liability and reduce that liability for payments made to the lessor.

If the lease payments are reduced in one period but increased by a lower amount in a later period (hence the total consideration is lower), the change in lease payments incorporates both a forgiveness of payments and deferred lease payments. A lessee applying the practical expedient measures the revised lease liability balance using the revised cash flows at the original discount rate. The change in the carrying amount of the lease liability is recognised as a gain in profit or loss.

As indicated in IFRS 16:BC205F, the lease liability recognised by a lessee applying the practical expedient should represent the present value of future lease payments owing to the lessor.

IASB educational material

The amendment to IFRS 16 discussed above provides a practical expedient to lessees applicable to lease concessions that arise as a direct result of COVID-19 and that meet certain other criteria.

On 10 April 2020, the IASB published more general educational material on COVID-19 related rent concessions and the accounting issues that may arise. The IASB educational material reflects the requirements of IFRS 16 other than the practical expedient.

Generally, lessees will find the amendments to IFRS 16 discussed above to be the most specific and relevant source of guidance for those lease concessions that meet the specified criteria. However, the educational material provides guidance that may be relevant for lessors as well as for lessees facing lease concessions that do not meet the criteria to be accounted for under the IFRS 16 amendments discussed above.

Key points from the educational material include:

- Changes in lease payments are analysed in the same way, regardless of whether they result from a change in the lease contract itself or in the applicable law or regulation;
- A lease modification arises if there is a change in scope of the lease and/or in the consideration for the lease that was not part of the original terms and conditions of the lease;
- An explanation that "[e]xamples of a change in the scope of a lease include adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term. A rent holiday or rent reduction alone is not a change in the scope of a lease";
- A further explanation that "[i]n assessing whether there has been a change in the consideration for a lease, an entity considers the overall effect of any change in the lease payments. For example, if a lessee does not make lease payments for a three-month period, the lease payments for periods thereafter may be increased proportionally in a way that means that the consideration for the lease is unchanged";
- A change in lease payments is not a lease modification if it results from clauses in the original contract or in the applicable law and regulation, even if the effect of those clauses was not previously contemplated. Instead, the effect of such rent concessions is generally accounted for as a variable payment;
- If a change in lease payments is a lease modification, a lessee applies IFRS 16:44-46 and a lessor applies IFRS 16:79 and 80 or IFRS 16:87; and
- If a change in lease payments results in extinguishment of part of a lessee's obligation under the lease, the lessee applies IFRS 9:3.3.1 to determine if part of the lease liability should be derecognised.

Additional guidance on the impact of rent concessions is available in our publication iGAAP on DART.

Consolidation

The COVID-19 pandemic may give rise to specific transactions or events that could change a reporting entity's governance rights over other legal entities and thereby affect accounting conclusions for consolidation.

In particular, loan agreements will commonly confer upon the lender rights that can be exercised in the event of the borrower breaching a loan covenant and/or defaulting on payments due under the loan agreement (e.g. the right to seize an asset provided by a borrower as collateral). Frequently, such rights are regarded as 'protective rights' and, consequently, are not considered to give the lender power over (and consequently control of) the borrower. However, in some circumstances, the rights are not merely protective and may give the lender power over the borrower on the occurrence of a breach or default.

When a lender's rights under a loan agreement are enforceable upon default or breach of a loan covenant by the borrower, in some circumstances the lender will have obtained control of the borrower. In determining whether it has obtained power over a borrower defaulting on a loan or breaching a covenant, a lender should consider:

- Whether the lender's rights are regarded as protective in nature both before and after the default or breach and hence do not give the lender power over the borrower;
- Whether the lender's rights have been amended as a result of the default or breach to give the lender power over the borrower; or
- Whether the terms of the loan agreement were originally designed to give power in the event of a default or breach.

When the rights give the lender power over the borrower in the event of a default or breach, if the other two elements of control exist (i.e. the exposure or rights to variable returns and the ability to use the power to affect the investor's returns), the lender has control over that entity.

Reporting time lags and consistency of accounting policies

IFRS 10 *Consolidated Financial Statements* requires that for purposes of the consolidated financial statements, the reporting date of a subsidiary corresponds to the date of the consolidated financial statements, unless it is impracticable to do so. When this is the case, the parent should consolidate the financial information of the subsidiary using the most recent financial statements of the subsidiary adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements. In any case, the difference between the date of the subsidiary's financial statements and that of the parent's financial statements should be no more than three months and the length of the reporting periods and any difference between the dates of the financial statements should be the same from period to period.

IAS 28 *Investments in Associates and Joint Ventures* includes similar requirements in respect of the financial statements of an associate or joint venture that an investor or joint venturer uses when applying the equity method.

In the current circumstances, if there is a time lag between the reporting date of a subsidiary and the consolidated financial statements (or between the reporting date of an equity method investee and the investor) it may be more likely that significant transactions or events will arise in the intervening period which will require adjustments to the financial statements of the subsidiary (or the equity method investee).

Local accounting standard-setters and regulators may have issued additional guidance on or provided reliefs from certain requirements of IFRS Standards in respect of accounting for the effects of COVID-19. When this is the case, the financial statements of subsidiaries, associates and joint ventures would need to be adjusted for the purposes of consolidation and application of equity method of accounting to ensure that uniform accounting policies are applied.

When a subsidiary prepares financial statements for a different reporting period, it is also necessary to review the subsidiary's statement of financial position to ensure that items are still correctly classified as current or non-current at the end of the group's reporting period. For example a breach in covenant that is determined to be a non-adjusting event in the financial statements of a subsidiary may require reclassification of the affected liabilities in the consolidated financial statements if these are prepared at a date after the date of the breach in covenant and if the lender has not waived its right to demand repayment for a period of at least 12 months from the date of the consolidated financial statements.

Acquisitions and disposals

Business combinations

The COVID-19 pandemic may be causing delays in closing financial transactions, including business combinations. A business combination is recognised on the date on which the acquirer obtains control of the acquiree. Appropriate identification of the acquisition date is key as it is the date on which the acquirer begins consolidation of the acquiree. It is also the date on which the acquirer measures, generally at fair value, the consideration transferred and the identifiable assets acquired, the liabilities assumed and any non-controlling interest and previously held interest in the acquiree.

Disposals and idle assets

In the current circumstances, entities may seek to dispose of certain assets or group of assets as a means to raise funds or certain assets may become idle or retired from active use. Other entities may have intended to dispose of assets prior to the COVID-19 pandemic but are now facing difficulties in identifying a buyer or in completing the sale.

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* requires that assets (or disposal groups) held for sale are not depreciated, are measured at the lower of carrying amount and fair value less costs to sell, and are presented separately in the statement of financial position. In order for the asset (or disposal group) to be classified as held for sale, it must be available for immediate sale in its current condition and the sale must be highly probable. In particular, the sale must be expected to qualify for recognition as a completed sale within one year from the date of classification as held for sale.

If an entity determines that an asset (or a disposal group) which has been classified as held for sale prior to the COVID-19 pandemic no longer meets the conditions for such a classification because the requirements and conditions discussed in this section are no longer met, the asset (or disposal group) should be removed from the held for sale category prospectively. The carrying amount of the asset (or the disposal group) is adjusted to the amount which would have been recognised had it never been classified as held for sale, taking into account any impairment losses.

As indicated in IAS 16:55, depreciation of an asset does not cease when an asset becomes idle or is retired from active use unless the asset is fully depreciated. If the depreciation is calculated by reference to the usage of the asset, however, the depreciation recognised may be zero while there is no production. In any case, when an asset becomes idle, or is retired from active use, this may trigger the recognition of an impairment loss which will result in the reduction of the carrying amount of the asset to its estimated recoverable amount.

Defined benefit plans

The significant economic uncertainty associated with the COVID-19 pandemic will affect the measurement of defined benefit obligations and plan assets.

IAS 19 *Employee Benefits* requires an entity to determine the present value of defined benefit obligations and the fair value of plan assets at the end of each reporting period. It encourages an entity to involve a professionally qualified actuary in measuring the obligations.

An entity's considerations related to the fair value measurement of financial and non-financial assets also apply to the measurement of plan assets under IAS 19. Pension plans may hold significant amounts of assets that do not have an active market, such as investments in hedge funds, structured products, and real estate assets that may become more illiquid, making their valuation more complex. Appropriately determining the fair value of such assets is important in the determination of the funded status of a defined benefit plan.

IAS 19:144 requires entities to disclose a sensitivity analysis for each significant actuarial assumption as at the end of the reporting period, showing how the defined benefit obligation would have been affected by changes in the relevant actuarial assumption that were reasonably possible at that date. Given the volatility in the markets, an entity's approach to the sensitivity analysis and the range of reasonably possible changes to existing actuarial assumptions may need to be revised.

For some entities, plan deficit or minimum funding requirements can result in large cash outflows and, in some circumstances, this could affect the ability of an entity to operate as a going concern (see Going concern). As a result of the financial impact of COVID-19, some entities may need to consider how to preserve cash to provide much needed liquidity. IAS 19 requires an entity to provide an indication of the effect of the defined benefit plan on the entity's future cash flows.

Share-based payments

Some businesses may cease operations or operate at reduced capacity as a result of the impacts of COVID-19, which could affect the probability that vesting conditions for share-based payments with performance conditions will be met. IFRS 2 *Share-based Payment* requires entities to recognise compensation expense for a share-based payment arrangement with a non-market performance condition in situations in which the outcome of the performance condition is probable. For example, if an award contains a non-market performance condition that affects vesting (such as an award that vests if a certain growth in profit is met) and it is not probable that the performance condition will be satisfied, any previously recognised compensation expense should be reversed. However, market conditions, such as a target share price upon which vesting is conditional, and non-vesting conditions are taken into account when estimating the fair value of the equity instruments granted. Therefore, for grants of equity instruments with a market or non-vesting condition, an entity needs to continue to recognise a compensation expense based on the original estimate of fair value if it is probable that all other vesting conditions will be met (e.g. service conditions), irrespective of whether the market or non-vesting condition is satisfied.

In addition, entities may decide to modify the terms or conditions of an equity-settled award, for example a change in the fair value-based measure, vesting conditions, or classification of the award. As a result of the modification, entities may need to recognise additional compensation expense for any incremental value provided (if the modification increases the fair value of the awards or additional awards are granted), or adjust the probability that the awards will vest in measuring compensation expense (if the vesting conditions are changed in a manner beneficial to the employees).

The cancellation of equity–settled awards, by the entity or the counterparty, is accounted for as an acceleration of vesting. The amount that would otherwise have been recognised for services received over the remainder of the vesting period is therefore recognised immediately. If new equity–settled awards are granted and at the time of grant identified as replacement awards for those that are cancelled, such cancellation and replacement is accounted for as a modification of the original equity–settled awards. Entities should be aware of the tax consequences that may be triggered by the cancellation or modification of share-based compensation awards.

Other employee benefits (including termination benefits)

Entities may be considering (or implementing) restructuring plans to mitigate their exposures associated with unforeseen consequences of the COVID-19 pandemic. Immediate actions may include measures to reduce their workforce through temporary employee layoffs. Further, entities may be forced to consider subsequent restructuring actions as information becomes available on the long-term effects of the pandemic on an entity's operations. In addition, in certain jurisdictions, governments may facilitate programmes to alleviate some or all of those costs (see the Government Assistance below discussion for further detail). In determining how to account for these measures, entities must start by identifying the nature and characteristics of each proposed action that is being considered because it may affect the timing of the recognition of the benefits provided to employees:

- *Stay bonus*—Some entities may offer special bonuses to employees as a reward for them working in these difficult conditions. Payments of these bonuses may be contingent on the employees continuing to provide services until a certain date. In such circumstances, the plan creates a constructive obligation as employees render service that increases the amount to be paid if they remain in service until the end of that specified period. The fact that some employees may leave without receiving payments offered under the bonus plans is reflected in the measurement of the obligation. It is not appropriate to defer recognition of the obligation until the employee completes the entitlement period.
- *Salary continuation, temporary suspension of employment*—Some entities may offer to continue to compensate employees even though they are not actively working during the suspension period, keeping the right to call employees back to work as necessary and preventing employees from taking up work elsewhere during the suspension period. When an entity uses a temporary suspension arrangement of this nature in order to reduce its employment costs during periods of reduced activity, the costs of the temporary suspension should be classified as a short-term benefit similar to a paid absence (e.g. holiday or leave pay). Short-term paid absences only give rise to a liability when they are accumulating, as discussed in IAS 19:13 and 18. This is not the case in the circumstances described, because the employees only have a right to receive payments as suspension occurs and for as long as suspension lasts. The entity has the discretion to ask some or all of its employees to return to work when the conditions will permit and revert to normal working arrangements and remuneration. Therefore, in these circumstances, the costs of suspension should be recognised over the suspension period and should not be accrued at the outset. Note that, in the circumstances described, the payments should not be classified as termination benefits; they are paid in exchange for suspension of the employees' employment rather than in exchange for termination of the employees' employment (as would be required under the definition of termination benefits in IAS 19:8)
- *Termination benefits*—If benefits are provided by the entity as a result of termination of employment, the entity should recognise its obligation at the earlier of either the date when it can no longer withdraw the offer of those benefits or the date when it recognises costs for a restructuring that is within the scope of IAS 37 and involves the payment of those termination benefits. IAS 19 provides further guidance to establish the date when the entity can no longer withdraw the offer. In particular, IAS 19:167 specifies that when the termination benefits are payable as a result of an entity's decision to terminate an employee's employment, the entity can no longer withdraw the offer when the entity has communicated to the affected employees a plan of termination meeting all of the following criteria:
  - Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made;
  - The plan identifies the number of employees whose employment is to be terminated, their job classifications or functions and their locations (but the plan need not identify each individual employee) and the expected completion date; and
  - The plan establishes the termination benefits that employees will receive in sufficient detail such that employees can determine the type and amount of benefits they will receive when their employment is terminated.

The measurement requirements for termination benefits are determined in accordance with their nature. Accordingly, as indicated in IAS 19:169, an entity should measure termination benefits as follows:

- If the termination benefits are an enhancement to post-employment benefits, IAS 19's requirements for post-employment benefits should be applied; otherwise
- If the termination benefits are expected to be settled wholly before 12 months after the end of the annual reporting period in which the termination benefit is recognised, IAS 19's requirements for short-term employee benefits should be applied; and
- If the termination benefits are not expected to be settled wholly before 12 months after the end of the annual reporting period, IAS 19's requirements for other long-term employee benefits should be applied.

Long-term intra-group foreign investments

Paragraph 32 of IAS 21 *The Effects of Changes in Foreign Exchange Rates* provides an exception that allows gains and losses on certain intra-group foreign currency items of a long-term investment nature to be recognised in other comprehensive income instead of being recognised in profit or loss. For an item to qualify as a long-term investment, the entity must be able to assert that "settlement is neither planned nor likely to occur in the foreseeable future". An entity that has characterised an intra-group item as part of its net investment in the entity may need to reassess whether that designation is still appropriate in the current economic environment. For example, an entity that plans to undergo restructuring because of the COVID-19 pandemic may need to reassess whether certain intercompany loans that had previously been determined to be of a "long-term investment nature" should continue to be accounted for as such if the loans could now be settled in the "foreseeable future" in connection with the restructuring plan.

Government assistance

In response to the COVID-19 pandemic, governments in many jurisdictions are considering, or have implemented, legislation to help entities that are experiencing financial difficulty stemming from the pandemic. Such assistance may be in the form of income-based tax credits that are dependent on taxable income or other forms of relief that is not dependent on taxable income (e.g. payroll tax credits, tenant reliefs and other similar subsidies).

IAS 20 has a broad scope exception encompassing "government assistance that is provided for an entity in the form of benefits that are available in determining taxable income or are determined or limited on the basis of income tax liability". Additionally, IAS 12 *Income Taxes* excludes from its scope government grants and investment tax credits, but does not define the term "investment tax credit". Therefore, a first step in accounting for the various measures offered by a government is determining whether they should be accounted for applying IAS 20 or IAS 12.

Some relief programmes will clearly be in the scope of IAS 20 because they are calculated and distributed to an entity without any link to taxable income (this may be the case for subsidies granted with respect to salaries of employees on temporary suspension). Other relief programmes will be clearly in the scope of IAS 12, for example, deferral of payment of income tax or temporary changes in the income tax rate applicable to an entity.

When a government provides support to an entity through investment tax credit, it is a matter of judgement under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to determine the most appropriate accounting treatment. It may be appropriate to analogise to IAS 12 or IAS 20. Generally, if an approach similar to IAS 12 is adopted, a credit will be recognised in profit or loss as part of income tax expense/income, and the related asset in the statement of financial position, when the entity satisfies the criteria to receive the credit (and the government measure is substantively enacted). If the substance of the arrangement is considered to be closer to a government grant, and an IAS 20 approach is adopted, the credit will be recognised in profit or loss over the periods necessary to match the benefit of the credit with the costs for which it is intended to compensate.

Government support may also be provided as forgivable loans or low interest loans. A forgivable loan from government, for which the government has undertaken to waive repayment under certain prescribed conditions, is treated as a government grant when there is reasonable assurance that the entity will meet the terms for forgiveness of the loan. The benefit of a government loan at a below-market rate of interest is also treated as a government grant. The loan is recognised and measured in accordance with IFRS 9. The benefit of the below-market rate of interest is measured as the difference between the initial carrying amount of the loan determined in accordance with IFRS 9 and the proceeds received. This benefit is accounted for in accordance with the general principles of IAS 20. The entity is required to consider the conditions and obligations that have been, or must be, met when identifying the costs for which the benefit of the loan is intended to compensate.

The effect of a government grant in the scope of IAS 20 is recognised when, and only when, there is reasonable assurance that the entity will comply with the conditions attaching to it and that the grant will be received. In some cases, an entity may be entitled to claim from the government the reimbursement of certain employee costs incurred. The entity should recognise an asset for the grant receivable when the employee costs are incurred and it is reasonably assured that it will receive the grant. For example, in June 2020 an entity applies for a COVID-19 related government grant intended to compensate eligible employment costs to be incurred in July 2020. If the grant is conditional on the entity actually incurring employment costs in July 2020 and the government approving the eligibility of the costs, the grant receivable would be recognised only when the employment costs have been incurred and the entity has reasonable assurance that the incurred costs will be eligible for the grant.

In other cases, government subsidies are available to entities that meet certain criteria (e.g. size or industry) but without further conditions (e.g. the subsidy is not conditional on the entity incurring certain costs or making certain investments). In these cases, having applied for the subsidy, the entity should recognise an asset if the eligibility criteria are met and it is reasonably assured to receive it.

In certain cases, an entity may receive the funds from a government grant in advance of incurring the costs that are intended to be compensated by the grant. For example, on 1 April 2020 an entity may receive CU4,800 intended to compensate 80% of the cost of furlough employees to be incurred in equal amounts in April and May 2020. If the entity calls back the employees to work before the end of May 2020, the entire amount of the grant must be repaid. Upon receipt of the funds, the entity would recognise the cash received with a corresponding liability. If the entity is reasonably assured that the employees will remain on furlough until the end of May 2020, it would recognise the benefit of the grant pro-rata over the 2-month period either as a separate line item or as a reduction of the related compensation expense (see discussion below). If the entity subsequently ceases to be reasonably assured that the employees will remain on furlough until the end of May 2020, this is accounted for as a change in estimate. The amount of the grant income previously recognised in profit or loss is reversed and a liability to the government is recognised until the grant is repaid.

Government grants are recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate. Care is needed in identifying which of the conditions give rise to costs and expenses, since those are the conditions that determine the period over which the grant is recognised in profit or loss.

A grant related to income (e.g. reimbursement of employment costs) is recognised as part of profit or loss either, as an accounting policy choice to be applied consistently to all similar grants:

- Separately or under a general heading such as 'other income'; or
- As a deduction in reporting the related expense.

A grant related to the acquisition of an asset is recognised in the statement of financial position either, as an accounting policy choice to be applied consistently to all similar grants:

- Recognising the grant as deferred income, which is recognised in profit or loss on a systematic basis over the useful life of the asset; or
- Deducting the grant in calculating the carrying amount of the asset, in which case the grant is recognised in profit or loss over the life of a depreciable asset by way of a reduced depreciation expense.

Governments may be providing support to entities through programmes that do not result in recognition of income in the financial statements of the participating entities. For example, certain governments are offering short-term debt facilities, sometimes in the form of commercial paper, to support liquidity of entities that were financially sound before the COVID-19 pandemic. Eligibility to the programme may be restricted to entities meeting certain criteria such as size or a pre-COVID-19 credit rating of investment grade. To the extent that the interest rate paid by the borrower and other terms of the debt instruments reflect market conditions, the borrowing does not include a government grant that requires recognition in the financial statements. Nevertheless, such support is considered government assistance under IAS 20. Entities will need to consider if the significance of the benefit received is such that disclosure of the nature, extent and duration of the assistance is necessary in order to avoid the financial statements from being misleading.

More broadly, to comply with the disclosure requirements in IAS 20:39, entities should provide clear disclosure regarding the impact of government assistance measures in terms of eligibility, conditions and consequences as well as in terms of the underlying judgements they have made.

Reduction in levies

In response to the financial difficulties encountered by entities, in many jurisdictions, governments have agreed to reduce the rate on certain levies for a predetermined period of time. For example, some governments have provided entities with relief from property taxes for the period from 1 April 2020 to 31 March 2021. It is appropriate, in such circumstances, for entities not to recognise a property tax expense for the corresponding period, in effect considering that the property tax rate is nil for the period. If material, the government assistance received should be disclosed.

Deferral of remittance of sales tax

To help entities facing liquidity issues, some government have offered all entities in their jurisdiction the option to postpone, for a fixed period, the remittance of sales tax collected by the entity on behalf of the government. Entities opting to defer payments are not charged interest by the government. If significant, entities will need to provide appropriate disclosure of their participation in the scheme, for example as part of their disclosure of cash management and liquidity risk.

Income tax

Entities should consider how profitability, liquidity, and impairment concerns that could result from the impacts of COVID-19 might also affect their income tax accounting under IAS 12. For example, a reduction in current-period income or the actual incurrence of losses, coupled with a reduction in forecasted income or a forecast of future losses, could result in a reassessment of whether it is probable that some or all of an entity's deferred tax assets can be recovered. Such assessments will be particularly challenging in situations in which the changes in current and projected future profitability actually result in, or are expected to result in, cumulative losses and the entity has not had a stable earnings history before the impacts of COVID-19. If declining earnings or impairments generate losses, entities also need to evaluate whether there is sufficient taxable income within the carryback and carryforward period available under tax law of the appropriate character to fully or partially realise the related deferred tax asset.

In addition, when assessing probable future taxable profits, entities should also ensure the reasonableness of their business plan and its impact on future taxable profits and the consistency of assumptions compared to projections used in other financial statements estimates for elements that should be comparable (e.g. goodwill impairment). The assumptions used should reflect the conditions in existence at the reporting date (see Events after the end of the reporting date for further information on the effect of subsequent events).

The rate and tax base used to calculate the deferred tax balances should reflect the manner in which the entity expects, at the end of the reporting period, to recover the asset or settle the liability. Accordingly, entities will need to consider whether strategies considered to address the challenges brought by the COVID-19 pandemic have an effect on the recognition and measurement of deferred tax amounts. This may be the case for example, if an entity plans to sell an asset to improve liquidity and the tax consequences of selling an asset are different from those resulting from using the asset in operations (the original intent of the entity).

Deferred tax consequences of adjustments to the carrying amounts of assets and liabilities (for example, as a result of impairment losses or decreases in the value of a pension surplus) will also need to be considered.

As permitted by IAS 12, an entity may have not recognised deferred tax liabilities for taxable temporary differences associated with subsidiaries, branches and associates, and interests in joint arrangements, because it controls the timing of the reversal of the temporary difference and it has been probable until now that the temporary difference will not reverse in the foreseeable future. Conversely, it may have recognised deferred tax assets for deductible temporary differences associated with such investments because it was probable that the temporary difference would reverse in the future (and it was probable that the deferred tax asset could be recovered). It may be appropriate to reconsider these conclusions if there is a change in intent with respect to repatriation of undistributed earnings in an investee to help with liquidity issues.

Tax relief and credits determined to be in the scope of IAS 12 should be reflected in the recognition and measurement of tax amounts only when the tax measure is substantively enacted. The assessment of whether a measure is substantively enacted depends on the relevant local legislative process. When an entity is uncertain of whether it will meet the conditions to be eligible for a substantively enacted tax measure, it should apply the requirements of IFRIC 23 Uncertainty over Income Tax Treatments. If an entity concludes that it is not probable that a taxation authority will accept its tax treatment, the entity should reflect the effect of the uncertainty in determining the related tax balances.

Other uncertain tax positions may also arise as a result of the consequences on the entity of the COVID-19. This may be the case for tax positions related to transfer pricing arrangements, where previously prepared benchmarking studies to support the policy may no longer be valid. Here again, the requirements of IFRIC 23 would apply.

Some jurisdictions establish whether an entity is subject to taxation in a jurisdiction based on residency, often determined by a “central management and control” test, which is determined based on factors such as physical attendance at board meetings. Travel restrictions may require entities to consider whether they have met all of the requirements to be subject (or not subject) to taxation in a jurisdiction.

Breach of covenants

Unstable trading conditions and shortages of cash flows in the affected regions may increase the risk that entities breach financial covenants. Entities should consider how the breach of a loan covenant may affect the timing of repayment of the related loan and other liabilities (e.g. it becomes repayable on demand) and how it affects the classification of the related liabilities at the reporting date.

If a breach occurs on, or before, the 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.

In contrast, a breach of loan covenants after the reporting date is a non-adjusting event that should be disclosed in the financial statements if the information is material (including the stage of the discussions with lenders to address the breach, if applicable). A breach after the reporting date could create uncertainty that raises substantial doubt about the entity’s ability to continue as a going concern.

The discussion above does not reflect the recent amendments to IAS 1 *Classification of Liabilities as Current or Non-current (Amendments to IAS 1),* which are effective for annual periods beginning on or after 1 January 2023. Before deciding to adopt these amendments in advance of their effective date, entities will need to consider carefully their impact on the classification of loans and other liabilities that are subject to covenants since this impact may be significant.

Interim financial reports

Entities preparing their interim financial reports applying IAS 34 *Interim Financial Reporting* are required to apply the same accounting policies as will be applicable in their next annual financial statements. All of the areas discussed in this publication will need to be considered when preparing interim financial reports applying IAS 34.

Going concern

The going concern requirements set out in IAS 1:25 and 26 apply to interim financial reports. Therefore, management will need to consider the extent to which the disruption of operations as a result of the COVID-19 pandemic and any other events or circumstances that affect the entity give rise to material uncertainties that cast a significant doubt on the entity’s ability to continue as a going concern for a period of at least 12 months from the end of the interim reporting period.

In making this assessment, management will need to take into account all information available up to the date of authorisation of the interim financial report.

The disclosure requirements discussed in the separate section 'Going concern' of this publication also apply to interim financial reports. Accordingly, the entity will need to consider whether new or updated information is required in the interim financial reports.

Recognition and measurement

The principles for recognising assets, liabilities, income and expenses for interim periods are the same as in annual financial statements. IAS 34:41 requires that measurement procedures used in interim financial reports produce information that is reliable, with all material relevant financial information being appropriately disclosed. Accordingly, the challenges described elsewhere in this publication, for example the timing of recognition of onerous provisions and special employee benefits arrangements or measurement of the recoverable amount of non-financial assets and of expected credit loss allowances on financial assets will need to be addressed in the same manner in interim financial reports. IAS 34 nevertheless acknowledges that, whilst reasonable estimates are often used for both annual and interim financial reports, interim financial reports will generally require a greater use of estimation methods than annual financial reports.

Another principle in IAS 34 is that the frequency of an entity's reporting (annual, half-yearly or quarterly) should not affect the measurement of its annual results. The notable exception to this principle is the recognition of impairment losses on goodwill, as addressed in IFRIC 10 Interim Financial Reporting and Impairment. An entity should apply the same impairment testing, recognition and reversal criteria at an interim date as it would at the end of its financial year. As explained in IFRIC 10, if an impairment test is performed in an interim period and results in the write-down of goodwill, the impairment loss must be recognised in the interim financial report and this impairment loss cannot be reversed in a subsequent period. This is the case even if matters improve in a subsequent interim period or by the end of the entity's financial year such that if the test was performed at the later date, the impairment loss on goodwill may be lower or may not exist.

The illustrative examples accompanying IAS 34 help to understand the application of the general recognition and measurements principles.

In particular IAS 34:B9 clarifies that the pension cost for an interim period is calculated on a year-to-date basis by using the actuarially-determined pension cost rate at the end of the prior financial year, adjusted for significant market fluctuations since that time and for significant one-off events, such as plan amendments, curtailments and settlements. This is especially relevant considering the significant fluctuations in market prices observed since the onset of the COVID-19 pandemic.

The requirements to recognised unallocated fixed overhead costs in profit or loss in the period in which they are incurred in case of abnormal reduction of production levels (see 'Valuation of inventories') will be of particular relevance to entities facing plant closures or lower demand in an interim period.

Finally, the requirements of IAS 10 addressed in 'Events after the end of the reporting period' are also applicable to interim periods. Whilst the impact of the COVID-19 pandemic may have affected the recognition and measurement of items in an entity's interim financial report, this does not mean that all events after the interim reporting date are adjusting events. Each significant event should be assessed to determine whether it provides evidence of conditions that existed at the end of the interim reporting period or whether it reflects a change in conditions after the end of the interim reporting period. Whilst not specifically required by IAS 34, in the current fast-changing environment, it may be relevant for entities to disclose the date of authorisation of their interim financial reports so that users know that the financial statements do not reflect events after this date.

Accounting for income taxes

Consistent with the basic principle that the same accounting recognition and measurement principles should be applied in an interim financial report as are applied in the next annual financial statements, the interim period income tax expense is accrued using the tax rate that would be applicable to expected total annual earnings, i.e. the estimated average annual effective income tax rate applied to the pre-tax income of the interim period.

To the extent practicable, a separate estimated average annual effective income tax rate is determined for each tax jurisdiction and applied individually to the interim period pre-tax income tax of each jurisdiction. The same principle applies when different income tax rates apply to different categories of income. As a result of the uncertainties brought by the COVID-19 pandemic, entities may face difficulties in performing the interim tax calculation with such a level of precision. If this is the case, entities are permitted to use a weighted average of rates across jurisdictions or across categories of income, if it is a reasonable approximation of the effect of using more specific rates.

As the entities make adjustments to forecasted income to reflect the COVID 19 impact on their operations and their expectations of the recovery period, these adjustments will need to be factored into an entity's estimated annual effective tax rate for interim reporting purposes under IAS 34. Furthermore, as companies put measures in place to respond to the challenges of the volatile and uncertain business environment these estimates of cash flows are likely to be revised more frequently and with that amounts accrued for income tax expense in one interim period may also need to be adjusted in a subsequent interim period if the estimate of the annual income tax rate changes. The estimated average annual income tax rate would be re-estimated on a year-to-date basis.

The criteria in IAS 12 to support the recognition of deferred tax assets are applied at the end of each interim period and, only if they are met, the benefit of a current period tax loss can be reflected in the computation of the estimated average annual effective income tax rate. Similar to the challenges addressed in the Income Tax section in this document, entities need to be consistent in their assumptions made around the impact of COVID 19 on future cash flows and their ability to generate taxable profits.

As noted in 'Income tax', expected changes in tax rates or tax laws, such as the COVID 19 related tax relief being introduced by many governments, should not be anticipated and will only be reflected in the estimate of the annual effective income tax rate once the changes have been enacted or substantively enacted. However, tax credits that relate to a one-time event are not blended into the effective annual tax rate and are recognised instead in computing income tax expense in the interim period in which that event occurs. Entities will need to consider the nature of any COVID 19 tax relief measures to assess whether their effect should be included in the annual effective tax rate or if their effect should be recognised in a specific interim period (for example, if a tax credit is in relation to a significant cost incurred in the interim period).

Whilst the illustrative examples accompanying IAS 34 are helpful in understanding how to measure interim income tax expense, a number of areas are not clearly addressed, including:

- One-off non-taxable events or one-off events that are taxable in a future period;
- Previously recognised deferred tax asset no longer expected to be recoverable;
- Change in tax rate that has an effect on a deferred tax balance carried forward or arising during the interim period but which is not expected to be reversed until the next financial year; and

For each of these, entities may adopt either of the following as an accounting policy choice to be applied consistently:

- Recognise the effect of the transaction on the effective tax rate in the period of the event; or
- Apply a constant tax rate throughout the year such that the effect of the transaction is recognised evenly over the annual period.

Disclosures

The overarching objective in IAS 34 is that the interim financial report should provide an explanation and an update to the relevant information included in the annual financial statement. Significant events and transactions resulting from the COVID-19 pandemic that may warrant disclosure include:

- Write-down of inventories to net realisable value.
- Recognition of a loss from the impairment of financial assets, property, plant and equipment, right-of-use assets, intangible assets, contract assets, or other assets.
- Disposal of property, plant and equipment.
- Changes in the fair value of investment properties
- Changes in the business or economic circumstances that affect the fair value of the entity's financial assets and financial liabilities (regardless of whether they are recognised at fair value or amortised cost).

- Any default or breach of a loan agreement that has not been remedied on, or before, the end of the interim reporting period.
- Changes in the classification of financial assets as a result of a change in the purpose or use of those assets.
- Employee termination costs
- Recognition of onerous contracts
- Change in contingent liabilities or assets.

In addition, IAS 34:16A requires the disclosures of specific information, including:

- Nature and amount of changes in estimates of amounts previously reported.
- Nature and amount of items affecting assets, liabilities, equity, net income or cash flows that are unusual because of their nature, size or incidence.
- Issues, repurchases and repayments of debt and securities.
- Events after the interim period that have not been reflected in the financial statements of the interim period.
- Effects of changes in the composition of the entity during the interim period, including losing control of subsidiaries, restructuring and discontinued operations.
- Specific information about the fair value of financial instruments required by IFRS 13 Fair Value Measurement and IFRS 7.

In addition to these specific items of information listed above, entities will need to consider any additional disclosures that may be needed to meet the overarching objective for disclosure stated above, which in the current volatile and uncertain environment may require additional disclosure of any significant impacts arising as a result of the events after the end of the interim reporting period.

Indeed, IAS 1:17 and 31 require additional information to that required by individual Standards, including IAS 34, when necessary to enable a user's understanding of the impact of particular transactions, other events and conditions. In the current context when an entity's financial situation may have changed significantly since its last annual financial statements, some of the disclosures that are normally only required by individual IFRS standards for a complete set of (annual) financial statements may be used to provide relevant information on the consequences arising from the COVID-19 outbreak in the interim reports. This may include the disclosures relating to the significant judgements and assumptions underlying these assessments and the sensitivity analyses (e.g. by expanding the range of reasonably possible changes of key assumptions), as required by IAS 1:122 and 125 (see Material judgements and estimates) and IAS 36:134(d) and 134(f) (see Assets subject to the requirements of IAS 36), as this update is likely to be significant to an understanding of the changes in an entity's financial position or performance since the last annual reporting period.

Other accounting considerations

Cash and cash equivalents

IAS 7 defines cash equivalents as short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Entities may need to consider whether investments classified as cash equivalents continue to meet the requirement for such a classification. If this is not the case, a change in classification of the investments may be required.

For example, entities should consider whether investments in funds, such as money market funds, have experienced a more than insignificant decrease in value. Also, clauses in the fund's documents may grant the fund manager the ability to restrict redemption in exceptional circumstances that may apply to the COVID-19 pandemic. When considering the impact of restrictions that may limit an investor's ability to redeem the units in the fund, consideration should be given as to whether those conditions exist at the reporting date, or are expected to exist in the short term following the reporting date, and therefore will limit the investor's ability to readily convert its units into a known amount of cash.

A change in classification as the result of a change in facts and circumstances is applied prospectively (i.e. the comparative period is not restated).

Capitalisation of borrowing costs

IAS 23 *Borrowing Costs* requires that borrowing costs which are directly attributable to the acquisition, construction or production of a qualifying asset be included as part of the cost of that asset. However, if the entity suspends activities related to development for an extended period, capitalisation of borrowing costs should also cease until such time as activities are resumed. As a result of COVID-19, entities may have interrupted the development and construction projects due to restrictions on activities imposed by government, cash flow difficulties or a desire to hold back development in uncertain market conditions. If this is the case, borrowing costs incurred during the period of suspension are not considered to be a necessary cost of development and therefore should be recognised as an expense.

Exchange rates

For practical reasons, it is common for entities that engage in a large number of foreign currency transactions to use a monthly or quarterly rate of exchange to measure those transactions in their accounting records and to disregard day-to-day fluctuations in exchange rates. When this approach is used, care must be taken to ensure that the result is not materially different from what it would have been if actual rates had been used for translation. As a result of COVID-19, entities may recognise large one-off transactions or be exposed to significant and unexpected movement in exchange rates. Entities will need to evaluate if foreign currency transactions should be analysed into shorter periods (e.g. quarterly periods, months or weeks) with an average rate determined for each, or even a date-specific exchange rate.

Webcast series on accounting considerations related to COVID-19

Deloitte has produced a video series to support businesses that are affected by COVID-19. These short and informative videos (4-10 minutes in length) supplement this I*FRS in Focus.*

Please click to access the videos on IAS Plus or on DART.

APPENDIX A: KEY CHANGES MADE TO THIS PUBLICATION SINCE 27 MARCH 2020

27 October 2020

Section	Change
Going concern	Clarification on disclosure
Liquidity risk management	Clarification on disclosure
Dividends and capital management	New subsection added, includes the section previously labelled Distributable profits
Contracts to buy/sell commodities	New subsection added, replacing the subsection financial vs non-financial assets and liabilities
Acquisitions and disposals - Disposals	Guidance on accounting for idled assets added
Share-based payments	Clarification of the impact of market and non-vesting conditions and of the cancellation and replacement of awards
Government assistance	Clarification of the timing of recognition of government grants and addition of new subsections addressing Reduction in levies and deferral of remittance of sales tax
Breach of covenants	Clarification that the guidance provided does not reflect the impact of the recent amendments to IAS 1 *Classification of Liabilities as Current or Non-current (Amendments to IAS 1)*

16 June 2020

Section	Change
Introduction	Addition of IOSCO's expectation in terms of transparency of financial reporting
Alternative performance measures	Addition of IOSCO's expectation in terms of non-GAAP financial measures
Impairment – Assets subject to the requirements of IAS 36	Clarification on frequency of performance of impairment test and on use of short cuts
Impairment – Valuation of inventories	Clarification on determination of net realisable value and cost
Lease contracts	Addition/modification to reflect issuance of the amendment to IFRS 16
Government assistance	Clarification on timing of recognition of grant, and on disclosure
Interim financial report	Clarification on disclosure required

4 May 2020

Section	Change
Alternative performance measures	New section
Revenue from contracts with customers	Various clarifications
Lease contracts	New subsection on the IASB exposure draft
Consolidation	New subsection on reporting time lags and consistency of accounting policies
Government assistance	Additional guidance on government assistance (other than grants)
Income tax	Clarification on assumptions used in estimating future taxable income
Interim financial reports	Additional guidance on the date of authorisation
Other accounting considerations	New section addressing cash and cash equivalent, capitalisation of borrowing costs and exchange rates

20 April 2020

Section	Change
Statement of profit or loss	New section
Going concern	Clarification of the disclosure requirements
Impairment of non-financial assets	Clarification of when it is appropriate to consider government assistance in the determination of cash flows
Lease contracts	Additional information on the publication by the IASB of educational material and expected exposure draft

7 April 2020

Section	Change
Interim financial reports	New section
Material judgements and uncertainties	Clarification that the disclosure of sensitivities of estimates is based on conditions at the reporting date
Revenue from contracts with customers	Additional explanation on variable consideration in the form of future penalties
Onerous contracts provisions	Clarification of the accounting for penalties on late delivery
Lease contracts	Additional explanation on how a lessee accounts for a modification

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