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Impact of COVID-19 on Financial Reporting

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1. Introduction

The outbreak of COVID-19 could have a number of potential accounting implications for entities, particularly those with subsidiaries, operations, investments, or joint ventures in areas affected by the virus.

Certain key accounting and disclosure considerations related to conditions may arise as a result of COVID-19. Entities must carefully consider their unique circumstances and risk exposures when analysing how recent events may affect their financial reporting. Specifically, financial reporting and related financial statement disclosures need to convey all material current or potential effects of COVID-19.

When reporting in uncertain times, it is particularly important to provide users of the financial statements with appropriate insight into the risks and uncertainties facing the entity and the judgements that have been made during the financial information preparation process.

In the absence of any consensus view of the future path of the COVID-19 pandemic and its impact on the economy, entities may not be able to apply consistent assumptions when there is such uncertainty. This lack of consistency makes the need for full disclosure of judgements, assumptions and sensitive estimates significantly more important than usual.

It is important that preparers of financial statements consider the following key aspects:

- How to assess whether the impacts of COVID-19 are material to the entity?
- When to adjust the financial statements, including where events continue to develop after the reporting period ends?
- What disclosures might be required of the entity (including any continuous disclosure obligations for listed entities)?

This document looks at certain key IFRS accounting considerations affected by the COVID-19 crisis.

Each key item will vary from entity to entity and vary by industry and some of the questions to be asked during this assessment process are:

- Are assets being carried at appropriate amounts?
- What is the impact on financial instruments and is it material?
- Is the going concern assumption appropriate?
- Are all financial liabilities properly recorded and presented?
- What is the impact on employee benefits?
- What is the impact on revenue recognition?
- Should lease contracts and recognition of leases be amended?
- How should government assistance be accounted for?
- Is COVID-19 an adjusting or a non-adjusting event?

2. Assessing Financial Impact

All financial statement preparers should consider the impact of Coronavirus (COVID-19) on interim and annual financial statements arising from this major global risk.

Direct financial impacts may include:

- asset impairment/changes in assumptions for impairment testing;
- change in fair value of assets or net realisable value of inventory;
- increased costs and/or reduced demand requiring provisions for onerous contracts,
- reassessment of variable consideration, including refund liabilities;
- changes in expected credit losses for loans and other financial assets
- material uncertainties that cast significant doubt on the ability to continue as a going concern.

Customers, suppliers, financiers or investments in other entities that may be affected, leading to impairments, increased costs or reduced revenues may have an indirect financial impact.

The impact of COVID-19 could be material if:

- there is a material financial impact; or
- users reasonably expect COVID-19 to impact your entity, regardless of whether there is a quantitative impact.

There are a number of complexities resulting from this crisis when using budgets and cash flow forecasts during the financial statement preparation process:

- 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.
- The effect of those macro conditions must be translated into estimates of future cash flows.

3. Non-financial assets

Requirement to test for impairment

International Accounting Standards (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). Entities are required to conduct impairment tests when there is an indication of impairment of an asset at the reporting date. 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.

Non-financial assets subject to the requirements in IAS 36 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

Non-financial assets (such as buildings, plant and intangible assets) are required to be tested for impairment at the end of each reporting period whenever there is an indicator of impairment.

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

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

Entities will need to assess whether the impact of COVID-19 has potentially led to an asset Impairment. The rapid deterioration in the economic environment and the increase in uncertainty in the sustainability of businesses have triggered a sharp fall in stock markets worldwide. It is therefore very likely that a triggering event has occurred in the first quarter of 2020 and the requirement for an impairment test has increased significantly, including for assets that are required to be tested for impairment annually.

Certain entities and affected industries such as events, leisure and tourism, may need to conduct impairment assessments of cash generating units in addition to the annual impairment consideration of goodwill and intangible assets with indefinite useful lives.

Indicators of impairment

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 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).

Disruptions to business operations and increased economic uncertainty due to COVID-19 may trigger the need to perform impairment testing in the 1st quarter of 2020.

Property, plant and equipment and intangible assets (other than goodwill)

Although some indicators of impairment are based on internal information (e.g. damage to property, plant and equipment, plans to remove the asset from use), others are triggered by events and circumstances external to the entity. Below are some examples of indicators of impairment that may exist as a result of the economic conditions caused by the spread of COVID-19:

- significant changes in the extent or manner in which the asset is used or is expected to be used (e.g. idling of a machine such that its future productive capacity may be affected, a machine being used in a manner different from its intended purpose – such as to produce items to support the battle against COVID-19 – which may reduce its future productive capacity)
- significant changes in the legal factors or business climate that could affect the value of the asset (e.g. an entity expects a decrease in its exports to a particular foreign market as a result of lengthy border closings)
- a decrease in market interest rates which would cause a decrease in the asset's value in use
- a decline in, or cessation of, the need for the services provided by the asset.
- decreased demand for the entity's products or service;
- increased costs/business interruptions due to supply chain issues;
- cancellations or postponements of orders by customers;
- need to provide significant concessions to customers;
- significant customers experiencing financial difficulties or cash flow difficulties.

Goodwill

Goodwill is required to be tested annually for impairment. COVID-19 could impact goodwill through:

- a significant adverse change in legal factors or in the business climate (e.g. an entity expects a decrease in its exports to a particular foreign market as a result of lengthy border closings)
- a loss of key personnel that is other than temporary (e.g. death)
- the testing for write-down or impairment of a significant asset group
- the recognition of a goodwill impairment loss in an investee's separate financial statements
- a significant decline in the entity's share price which could result in the carrying amount of the entity's net assets exceeding its market capitalisation.

Impact on useful life and residual value

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

Changes in assumptions used for impairment testing

Estimating cash flows

The impairment test often requires the development of cash flow projections that may be significantly affected by the direct or indirect impacts of recent and ongoing events. Revised financial estimates of future earnings may be indicative of the need for potential impairment of non-financial assets.

Entities often rely on discounted cash flows in estimating recoverable amounts. Estimating future cash flows to calculate the recoverable amount of an asset will be challenging given the high level of uncertainty. 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. Due to the high degree of uncertainty and resulting challenges in forecasting cash flows, it could be helpful to base those forecasts on external sources such as economic projections by respected central banks and other international organisations.

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 or the benefits of the possible government assistance 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.

Discount rate

The discount rate to be used is an estimate of the rate that a market participant would expect on an equally risky investment. Therefore, 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. The addition of a "COVID-19" risk premium to the discount rate may be difficult as there is no evidential base to support the quantum of the adjustment.

Approach to projecting cash flows

Two approaches can be used to project cash flows:

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

Given the high degree of uncertainty, entities may consider using an expected cash flow approach as opposed to the traditional approach. Under the traditional approach, cash flows are not adjusted for risk but, rather, risk is reflected in determining the discount rate. Under the expected cash flow approach, the uncertainty about the future cash flows is reflected in the different probability-weighted cash flow projections used, rather than in the discount rate.

While an expected cash flow approach is highly dependent on assigning probabilities to estimates of future cash flows, such judgements on the inputs may be more transparent and more readily tied to underlying commercial expectations than the addition of a "COVID-19" risk premium to the discount rate.

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 or forecasts, approved 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.

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

Adjusting or non-adjusting event

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, entities 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). However, 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.

Disclosure requirements

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.

Ask the following questions:

1. How does the COVID-19 event affect the use of our assets? Are there interruptions in the business operations and what is the impact of assets not being used (idle) due to this event?
2. Are the COVID-19 event and the measures taken to control likely to reduce future cash inflows?
3. Are the COVID-19 event and the measures taken to control likely to increase operating and other costs?
4. Should the assumptions and cash flow forecasts used to test for impairment be updated to reflect the potential impact of COVID-19?
5. Do we need to revise budgets, forecasts and other assumptions used during our earlier impairment testing date for determining the recoverable amount so to reflect the economic conditions at the balance sheet date, specifically to address our increased risk and uncertainty?
6. Should we revise the factors used to determine the discount rate to reflect the impact of and risk associated with COVID-19?
7. Do the budgets and cash flow projections reflect the following (where applicable), based on information available at the reporting date:
   - projections of central banks and other international organisations about the duration and severity of the impact of COVID-19;
   - supply of and demand for the CGU's products or services;
   - the decline in economic activity;
   - the impact of restrictions on transport, travel and quarantines;
   - the impact of exchange rates and commodity prices; and
   - the fiscal stimulus, liquidity provision and financial support from the state or international organisation
8. Was this information available at the reporting date? Do the assumptions being used to determine the recoverable amounts reflect the conditions existing at reporting date?
9. What additional information is required to be disclosed in the financial statements? Do the disclosures include information on the assumptions and sensitivities?

4. Inventories

Accounting treatment of inventories

International Accounting Standards (IAS) 2 *Inventories* prescribes the accounting treatment for inventories. Applying IAS 2 *Inventories*, inventories are measured at the lower of their cost and net realisable value (NRV).

Net realisable value

The determination of NRV may pose troublesome during the COVID-19 economic downturn.

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.

Disruptions to manufacturing and transportation into and out of coronavirus-affected areas as well as depressed demand for an entity's products may result in the NRV of inventory falling below cost.

Costing of inventories

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. Manufacturing entities may have to reassess their practices for fixed overhead cost absorption if production volumes become abnormally low utilisation of production capacity 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 review should ensure that unallocated fixed overhead costs are recognised in the statement of profit or loss as oppose to capitalisation of these overheads against the cost of inventories.

Recoverability of inventory balances

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.

Perishables, products with short shelf lives or expiration dates, or specific seasonal inventories are at the most risk of an impairment.

Ask the following questions:

1. How does the COVID-19 event affect the manufacturing production?
2. Have production levels decreased significantly because of COVID-19?
3. How does the decreased production levels affect the allocation of overheads to the cost of inventory? Should the method of cost allocation be revised?
4. Do we have lower than expected sales due to COVID-19?
5. Is it necessary to write-down inventories to net realisable value?
6. Have inventory items become obsolete? Should this be written off?
7. Was this information available at the reporting date? Should the financial statements be adjusted?
8. What additional information is required to be disclosed in the financial statements?

5. Financial Instruments

Allowance for expected credit losses (ECL)

IFRS 9 *Financial Instruments*, requires an entity to incorporate reasonable and supportable information about past events, current conditions and the forecast of future economic conditions into the assessment of expected credit losses (ECL) for financial assets not measured at fair value through profit or loss. 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 negative economic outlook and cash flow difficulties experienced by customers as a result of COVID-19 must be factored into an entity's forecasts of future conditions, which may result in an increase in its provision for ECLs to reflect:

- a greater probability of default across many borrowers, even those that currently do not exhibit significant increases in credit risk but may in the future; and
- a higher magnitude of loss given default, due to possible decreases in the value of collateral and other assets.

Such an assessment should be based on information at the reporting date and adjusted for subsequent available information where applicable.

ECL applies to trade receivables, loans, debt securities, contract assets and assets arising from costs to obtain or fulfil a sales contract, as well as the losses recognised in measuring loan commitments and financial guarantee contracts. Regardless of whether the simplified approach or the 3-stage model set out in IFRS 9 is being applied to assess ECL, the impact on the ECL calculation as a result of COVID-19 needs to be very carefully assessed. The impact of COVID-19 on ECL will be particularly challenging and significant for banks and other lending businesses.

The following factors should be considered when measuring ECLs:

- The increased uncertainty about potential future economic scenarios and their impact on credit losses may require entities to explicitly consider additional economic scenarios when measuring ECLs. [IFRS 9.B5.5.42]
- Existing ECL models will use historical experience to derive links between changes in economic conditions and customer behaviour, and ECL parameters such as loss rates, probabilities of default and loss given default. However, these historical relationships are unlikely to read across to the COVID-19 pandemic. Therefore, adjustments to model results, based on expert credit judgement, could be necessary to reflect the information available at the reporting date appropriately.
- Certain types of customers, industries or regions may be particularly severely affected by the economic effects of COVID-19. Entities with exposure to these customers, industries or regions will need to consider whether this is appropriately captured in their ECL measurements.

- Governments and central banks are launching measures to mitigate the adverse impact of COVID-19 on banks and borrowers. Entities may need to consider this when estimating ECLs.
- Many borrowers are drawing down credit lines or holding on to cash to obtain additional liquidity to help them weather the economic storms. This will be relevant for estimating exposures from loan commitments and prepayable or extendable loans.
- The expected cash flows used in measuring ECLs may also be affected by any actions planned by the entity (e.g. modification, forbearance, limit extensions). [IFRS 9.5.5.12]
- In addition, limit increases for credit cards may impact the period of exposures assessed under paragraph 5.5.20 of IFRS 9.

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. The difficulties associated with making estimates and assumptions in these uncertain times would not be a basis for entities not to update ECL measurements. To the extent that information about the impact of COVID-19 that becomes available after the reporting date provides more evidence about conditions at the reporting date, entities will need to revisit their estimates of ECL at the reporting date.

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. IFRS 9 requires that historical loss rates are adjusted as appropriate to reflect current conditions and estimates of future economic conditions.

COVID-19 will require entities to 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, interentity 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

An entity that has guaranteed an amount owing by another entity/individual should consider how the other entity/individual is impacted by the current global situation. Depending on the circumstances, the entity may need recognise an additional liability related to the guarantee which would be the higher of the ECL and the amount initially recognised less amortisation.

Parent entities sometimes issue financial guarantee contracts 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 financial guarantee contracts 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.

Ask the following questions:

1. How do we measure ECL? Is it measured at a 12-month or lifetime ECL?
2. Has COVID-19 increased the credit risk (risk of default) significantly?
3. What is the effect of other detrimental developments for the economy on forward-looking adjustments for the purpose of measuring ECL?
4. Is the amount and timing of the expected credit losses and allocation of probabilities based on reasonable and supportable information?
5. Was this information available at the reporting date? Should the financial statements be adjusted?
6. What additional information is required to be disclosed in the financial statements?

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

Hedge effectiveness assessment is required to be performed at the inception and on an on-going basis at each reporting date or in case of a significant change in circumstances, whichever occurs first. If the COVID-19 outbreak reduces the probability of a hedged forecast transaction occurring or affects its timing, then the hedge accounting relationship may need to be terminated or there may be hedge ineffectiveness.

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.

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.

Financial vs non-financial assets and liabilities

The significant disruption to supply and demand may result in net cash settlement of contracts to buy or sell commodities or other nonfinancial assets that were previously expected to be physically settled and were accounted for as own use contracts. The expected net cash settlement of contracts to buy/sell non-financial items (e.g. commodities) will bring those contracts in scope of IFRS 9 and may result in classification of the contracts as financial assets or liabilities.

Entities sometimes enter into transactions where cash is prepaid for the supply of non-financial items, e.g. for commodities such as oil. 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 financial instruments and classified as financial assets or financial liabilities.

Debt repayment and classification

Some financial institutions (and other creditors) are providing debtholders with the option to defer principal payments for a period of time. Entities will need to assess whether the change in terms represent a modification or extinguishment of the debt obligation and revisit the portion of the debt that is considered current versus non-current.

As a result of the difficult economic conditions, an entity that is normally able to comply with its debt covenants may find that it is now in violation. In some instances, creditors may not be willing to waive their right to demand repayment. Unless the entity meets certain conditions, it may need to present the entire amount owing as a current liability.

Derecognition of debt or other liabilities

If a creditor forgives an amount owing by an entity, entities need to carefully consider the point in time when the liability is discharged and can be derecognised along with the appropriate accounting treatment

Interests in associates and joint ventures

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*.

Disclosures

Due to the rapidly changing economic environment, an entity may find that it is subject to new or increasing risk (e.g. credit, liquidity, or market risk) or concentrations of risk. In addition, an entity may find that its risks have changed from the prior period. Entities should evaluate whether additional risk disclosures are required.

Expected credit losses

The methods, assumptions and information used to measure ECLs – e.g. an entity may need to explain how it has incorporated updated forward-looking information into measuring ECLs, in particular:

- how it has dealt with the challenge of ECL models that were not designed for the current economic shocks; and
- how it has calculated overlays and adjustments to these models.

Quantitative and qualitative information that allows evaluation of the amounts arising from ECLs; the types of analysis disclosed previously may need to be adjusted or supplemented to clearly convey impacts arising from COVID-19. [IFRS 7.35H-L]

If an entity changes its ECL methodology in order to better estimate the impact of the outbreak in accordance with the requirements of IFRS 9, the entity should disclose the change of the estimation technique and the reasons for its change.

Credit risk management

Entities should provide qualitative and quantitative disclosure to enable users of financial statements to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows. This includes the basis of inputs and assumptions and estimation techniques used, and how forward-looking information has been incorporated. How entities determined whether the credit risk of the financial instrument has increased significantly since initial recognition. The methods and indicators used may have changed in response to the current conditions – e.g. additional collective assessments may have been performed or financial instruments may have been grouped differently. [IFRS 7.35F]

Information about an entity's credit risk management practices and how they relate to the recognition and measurement of ECLs. An entity may have changed its risk management practices in response to COVID-19 – e.g. by extending debt relief to borrowers or by following specific guidance issued by governments or regulators. [IFRS 7.35F]

Liquidity risk management

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.

Sensitivity analysis

IFRS requires that an entity disclose a sensitivity analysis (including quantitative disclosures) pertaining to changes in the relevant risk variable that are "reasonably possible" at the reporting date. Entities may need to perform sensitivity calculations using a larger range for the risk variables or consider a direction of change that reflects expectations resulting from the COVID-19 pandemic.

Hedge accounting

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

Examples of specific disclosures include:

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

6. Fair value measurements

The fair value of an asset or liability should reflect market conditions at the measurement date. 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.

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

- Economic activity levels: Measures taken to contain the virus may lead to a significant reduction in economic activity in terms of production of and demand for goods and services, and may have a negative impact on forecast future cash flows used in a discounted cash flow valuation method.
- Credit risk and liquidity risk: The uncertain economic environment has resulted in increases in credit risk and liquidity risk for many entities. Own credit risk and/or counterparty credit risk used as inputs into valuation techniques may therefore increase.
- Forecasting risk: Fair value measurements should reflect the greater uncertainty in making economic and financial forecasts in the near term, due to the difficulty in forecasting the magnitude and duration of the economic impact of COVID-19.
- Foreign exchange risk: Entities with significant sales or purchases in foreign currencies may be adversely affected by exchange rate movements.
- Commodity price risk: Entities in extractive industries may be significantly affected by decreases in commodity prices. Entities in countries that are economically dependent on these commodities may also have greater risk of adverse economic impacts.

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

Fair value measurements (such as those involved in measuring, for example, certain financial instruments and investment properties) should reflect market participant views and market data at the measurement date under current market conditions. 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 input used reflect how market participants would reflect the effect of COVID-19, if any, in their expectations of future cash flows related to the asset or liability at the reporting date.

Disclosure requirements

The key assumptions and judgements made by management must also be disclosed to enable users to understand how fair value has been determined. IFRS 13 also contains specific disclosure requirements when amounts are transferred into Level 3 of the fair value hierarchy, including sensitivity disclosures. [IFRS 13.93(e)(iv), 93(h), IAS 1.125, 129]

It may be necessary to provide sensitivity disclosures given the impact of the increase in economic uncertainty on forecasting cash flows and other unobservable inputs used in valuation techniques.

8. Leases

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

IFRS 16 *Leases* contemplates that changes may occur in lease payments over the term of a lease. The required accounting for such changes (if material) involves the application of judgement and depends on a number of factors, including importantly whether those changes were part of the original terms and conditions of the lease.

Reassessment of options

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

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

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

Changes in the non-cancellable period of a lease

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

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

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

Right-of-use assets

IAS 36 *Impairment of Assets* applies in determining whether right-of-use assets (for lessees) and items of property, plant and equipment subject to an operating lease (for lessors) are impaired. The circumstances that give rise to rent concessions as a result of the COVID-19 pandemic are likely to indicate that assets may be impaired.

For example, loss of earnings during the period covered by a rent concession, 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, may be an indicator of impairment of the related right-of-use asset. Similarly, longer-term effects of the COVID-19 pandemic could affect the expected ongoing economic performance of right-of-use assets.

Lessors will also need to consider the applicable requirements of IFRS 9, for example when accounting for any impairment of lease receivables.

Rent concessions

To account for a rent concession under IFRS 16 *Leases,* entities first need to determine the nature of the rent concession. Many rent concessions will meet the definition of a lease modification – i.e. a change in scope or consideration that was not part of the original terms and conditions of the lease. In other cases, the original terms and conditions of the lease may include a mechanism to adjust rents if certain events occur. When this is the case, the rent concession will often represent a variable lease payment.

Lessees

Lessees in some affected markets may receive rent abatements or other economic incentives. Generally, the accounting treatment for lease rent concessions will depend on whether:

- the lessee was entitled to the economic relief (i.e. the contractual arrangement or jurisdictional laws provide an enforceable right) or
- 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).

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.

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.

Lessors

If the lessee receives tenant 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.

Lease modifications

Changes may occur in lease payments over the term of a lease. The required accounting for such changes (if material) involves the application of judgement and depends on a number of factors, including importantly whether those changes were part of the original terms and conditions of the lease. Changes could arise directly from amendments to the lease contract itself or indirectly—for example, from actions of government in response to the covid-19 pandemic.

IFRS 16 sets out specific requirements for how to account for some changes in lease payments—for example, those arising from changes in an index or rate used to determine lease payments. Otherwise the accounting required by IFRS 16 for a change in lease payments depends on whether that change meets the definition of a lease modification.

Assessing whether a change in payments is a lease modification

IFRS 16 defines a lease modification as a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease.

In assessing whether there has been a change in the scope of the lease, an entity considers whether there has been a change in the right of use conveyed to the lessee by the contract—examples 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.

In 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. If there is no change in either the scope of the lease or the consideration for the lease, then there is no lease modification.

If there has been a change in either the scope of or the consideration for the lease, an entity next considers whether that change was part of the original terms and conditions of the lease. An entity applies paragraph 2 of IFRS 16 and considers both the terms and conditions of the contract and all relevant facts and circumstances. Relevant facts and circumstances may include contract, statutory or other law or regulation applicable to lease contracts.

Government action (for example, requiring the closure of retail stores for a period of time because of covid-19) might be relevant to the legal interpretation of clauses, such as force majeure, that were in the original contract or in applicable law or regulation. Changes in lease payments that result from clauses in the original contract or in applicable law or regulation are part of the original terms and conditions of the lease, even if the effect of those clauses (arising from an event such as the covid-19 pandemic) was not previously contemplated. In such a case there is no lease modification for the purposes of IFRS 16.

Changes in payments that are not lease modifications

If a change in lease payments does not result from a lease modification, that change would generally be accounted for as a variable lease payment. In this case, a lessee applies paragraph 38 of IFRS 16 and generally recognises the effect of the rent concession in profit or loss. For an operating lease, a lessor recognises the effect of the rent concession by recognising lower income from leases.

Incremental borrowing rate

Determining the incremental borrowing rate (IBR) – it is often necessary for a lessee to calculate an IBR in order to account for most leases under IFRS. Due to the impact of the COVID-19 pandemic, including changes to interest rates and to the entity's own credit risk, this rate may need to be reconsidered.

Partial lease liability extinguishment

If a change in lease payments results in the extinguishment of a part of a lessee's obligation specified in the contract (for example, a lessee is legally released from its obligation to make specifically identified payments), the lessee would consider whether the requirements for derecognition of a part of the lease liability are met applying paragraph 3.3.1 of IFRS 9 *Financial Instruments*.

Other considerations

Lessors should consider whether:

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

Disclosure

Apart from the disclosure requirements of IFRS 16, lessors and lessees must also apply the disclosure requirements of other IFRS Standards, such as IAS 1 *Presentation of Financial Statements*.

For example, IFRS 16 requires both lessees and lessors to disclose information that gives a basis for users of financial statements to assess the effect that leases have on their financial position, financial performance and cash flows. The information disclosed will need to be sufficient to enable users of financial statements to understand the impact of COVID-19-related changes in lease payments on the entity's financial position and financial performance [IAS 1.31).

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

Ask the following questions:

1. Have the COVID-19-related events and circumstances triggered a requirement to reassess renewal, termination or purchase options of leases?
2. What is the impact of the changes in economic conditions for the entity to exercise, or not exercise, such options?
3. Are any of the rent adjustment clauses in existing lease contracts triggered in the current conditions?
4. Does the change in payments represent a modification to the lease contract?
5. Have the COVID-19-related events and circumstances triggered the need for an impairment test of right-of-use assets?
6. What are the key judgements in assessing the nature of the rent concession and discount rates?
7. Do the disclosed in the financial statements provide clear and meaningful information about judgements and estimates made during lease options, terminations and rent concessions?

9. Revenue

Revenue recognition

The recognition of revenue is prescribed by International Financial Reporting Standards (IFRS) 15 Revenue from Contracts with Customers. Under IFRS 15, entities account for a contract with a customer only when the agreement creates enforceable rights and obligations under the law. That is, an entity recognises revenue if, and only if, the contract passes the contract existence test in Step 1 of the five-step model for revenue recognition.

If a new contract with a customer does not meet all of the contract existence criteria, then revenue is not recognised. Entities may need to reassess whether the contract existence criteria continue to be met for existing contracts – i.e. if there is a significant change in facts and circumstances. If an existing contract with a customer no longer meets these criteria, then an entity stops recognising revenue for that contract. [IFRS 15.13]

The COVID-19 coronavirus outbreak has disrupted many industries and created uncertainties that may affect the timing and amount of revenue significantly. For example, entities may need to consider the following.

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

An entity's sales and revenue might decline as a result of the reduced economic activity following the steps taken to control the virus. This is accounted for when it happens. However, there could also be an effect on the assumptions made by management in measuring the revenue from goods or services already delivered and in particular on the measurement of variable consideration.

Where goods and services have been or are being rendered to customers who are either based in regions impacted by COVID-19 or significantly impacted by it, entities will need to assess whether collection is probable while evaluating new contracts. In the absence of such probability, entities may not be able to recognise revenue until or unless payment is received and becomes non-refundable, because such contracts are unlikely to meet the criteria to apply the normal IFRS 15 approach.

IFRS 15 is applied only to those contracts where it is expected for a customer to meet its obligations as they fall due. Entities might choose to continue to supply a customer even when it is aware that the customer might not be able to pay for some or all the goods being supplied. Revenue is recognised in these circumstances only when it is probable that the customer will pay the transaction price when it is due net of any price concession.

Revenue recognition over time

When an entity transfers control of a good or service over time, revenue is recognised by measuring the progress towards complete satisfaction of that performance obligation. This is common in sectors such as real estate, construction, engineering, aerospace and defence.

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

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

Contract modifications

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

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

Accounting for contract modifications can be complex. There are different approaches for different circumstances, depending on factors such as how the modification is priced and whether the current contract is being accounted for over time.

Variable components

IFRS 15 requires that variable consideration is recognised only when it is highly probable that amounts recognised will not be reversed when the uncertainty is resolved. Variable consideration includes discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties and other similar items. Entities should reconsider both its estimate of variable consideration and whether the recognition threshold is met. The revenue of an entity may decline as a result of the spread of the virus and the economic impact.

If the entity's contract with the customer includes variable components, the entity must consider whether its previous estimates in this regard continue to be appropriate. IFRS 15 provides extensive guidance around variable consideration and the related constraint. It may be necessary for an entity to begin constraining its variable revenue even if this was not considered necessary prior to the COVID-19 pandemic.

Penalties

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. 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.

Onerous contracts

Onerous contracts may arise when the unescapable costs of satisfying contractual obligations exceed the anticipated benefits to be received. Revenue contracts containing penalties for late or non-fulfilment of performance obligations may constitute onerous contracts with intricate accounting implications.

For example, an entity might face penalties as a result of delays or incur increased costs that cannot be recovered due to replacing employees or finding alternative suppliers. Entities need to consider whether any contracts are in an 'onerous' position and whether a liability needs to be recognised.

Government assistance

Governments around the world have reacted to the impact of COVID-19 with a variety of measures, including tax rebates and holidays and, in some cases, specific support for businesses in order that those businesses are able to support their customers. Entities should consider whether this type of assistance received from a government meets the definition of a government grant in IAS 20 Government grants. The guidance in IAS 20 should be applied to a government grant.

Compensation for business interruption

Insurance proceeds may compensate an entity for business interruption – e.g. for lost profits caused by COVID-19. The ability to claim these proceeds will depend on the specific terms of the insurance contract, actions taken by the government and interpretation of the applicable law. For example, if all restaurants are ordered to close by the government, then they may be able to claim under their insurance contracts.

Lost profits, by themselves, do not give rise to a provision. Therefore, compensation for business interruption is not a reimbursement right under IAS 37 and should be accounted for as a receivable when it has an unconditional right to receive the compensation.

An entity would have an unconditional contractual right to receive compensation if:

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

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

Disclosure

IFRS 15 requires that an entity disclose information that allows users to understand the nature, amount, timing and uncertainty of cash flows arising from revenue. This might require for example, information about how an entity has applied its policies taking into account the uncertainty that arises from the virus, the significant judgments applied, for example whether a customer is able to pay, and the significant estimates made, for example in connection with variable consideration.

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

10.Other Obligations

New employee benefits and termination benefits

In response to the COVID-19 pandemic, some entities are providing additional benefits to their employees such as:

- paying them during a temporary shutdown of their operations, or while they are sick or in mandatory quarantine; and/or
- providing other compensation to assist employees with working remotely.

If an entity decides to provide new benefits to its employees (i.e. those that were not previously offered), it must determine how to account for the benefits. The financial support or benefits offered to employees will likely meet the definition of a liability; therefore, an entity will need to consider when to recognise the liability/expense and how it should be measured.

Entities should also consider whether it has a legal or constructive obligation to its employees in connection with the virus, for example sick pay or payments to employees that self-isolate, for which a liability should be recognised. Furthermore, as a result of difficult economic conditions, some entities have or will downsize their workforce. If the entity offers or is required to pay termination benefits to the affected employee(s), entities must consider how and when to account for the liability/expense in accordance with IFRS.

The entity must first determine whether the benefits provided are a result of past service or if they will be provided as services are rendered because that will impact when the liability is recognised. The specific guidance in IAS 19 'Employee Benefits' must be considered when making this determination.

IAS 19 Employee benefits requires that a liability for employee termination is recognised only when the entity can no longer withdraw the offer of those benefits or the costs of a related restructuring are recognised in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

IAS 19 requires extensive disclosure of the assumptions used to estimate employee benefit liabilities, together with sensitivities and changes in those assumptions.

Restructuring provision

Under IAS 37 a restructuring provision is recognised only when both of the following conditions are met:

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

Example: An entity makes a decision to close down one of its production facilities as a result of COVID-19. If the entity announces its plan, specifying the facility to be closed, the estimated timing of the closure and the approximate number of employees it plans to make redundant, then it recognises a restructuring provision. The approval of the restructuring plan is not by itself sufficient to recognise a restructuring provision. [IAS 37.75]

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

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

Defined benefit obligations

Measuring a defined benefit obligation involves making estimates and the use of assumptions (e.g. the appropriate interest rate, future salary increases and employee turnover).

Given the sudden fall in markets and the decline in high quality corporate bond rates that have occurred as a result of COVID-19, an entity should consider the impact on its defined benefit obligation(s).

Most entities obtain full actuarial valuations approximately once every three years or as required by their regulator. In between, their actuary may perform a more limited update to roll forward the figures for financial reporting purposes, although an up-to-date valuation of plan assets is normally required at each reporting date. Entities should consider whether the estimate needs to be adjusted, or a more comprehensive valuation obtained, as a result of the impact of COVID-19.

Entities should have discussions with their actuaries, to ascertain whether COVID-19 has impacted any assumptions in their reports such that their estimates may need to be revisited. The guidance related to subsequent events on whether there may be an adjusting or non-adjusting event should also be considered.

Share-based payments

Entities with share-based payments whose vesting depends on achieving non-market performance conditions – e.g. earnings per share targets – may need to revise their estimate of the number of instruments expected to vest, which would impact the charge in the income statement over the remaining vesting period. However, expectations of achieving market performance conditions – e.g. achieving a specified total shareholder return and non-vesting conditions – and grant-date fair value are not revised. For example, the yield on high-quality bonds or the risk-free interest rate in a particular currency might have changed as a result of recent developments or the probability of an employee meeting the vesting conditions for bonuses or share based payments might have changed.

Entities should consider the impact of any changes made to the terms of, for example, a share-based payment plan, to address the changes in the economic environment and the likelihood that performance conditions will be met. To the extent that such changes are beneficial to the employee, they would be accounted for as a modification and an additional expense recognised. Entities should be aware that cancelling a share-based payment award even if the vesting conditions are unlikely to be satisfied results in the immediate recognition of the remaining expense. Modifications to share-based payment arrangements will need to be assessed as to whether they are either beneficial or non-beneficial to the employee and accounted for accordingly.

IFRS 2 Share based payment requires that entities explain modifications to share based payments, along with the incremental fair value granted, as well as information about how the incremental fair value was determined.

Onerous contracts provisions

Onerous contracts are those contracts for which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. Unavoidable costs under a contract are the least net cost of exiting the contract (that is, the lower of the cost to exit or breach the contract and the

cost of fulfilling it). Such contracts might include, for example, supply contracts that the entity is not able to fulfil because of the virus

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. Entities should consider whether any of its contracts have become onerous. IAS 37 requires recognition of a provision in respect of an onerous contract.

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

- Revenue from contracts with customers containing penalties for late or non-delivery;
- 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.

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.

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

The provision for an onerous contract is discounted if the effect of the time value of money is material. Central banks in many countries are cutting interest rates in response to increasing concerns about the economic impact of COVID-19; this in turn may impact risk-free rates, which are often used to discount provisions. Entities need to update the discount rate if it has changed. Before recognising a provision for an onerous contract, all assets dedicated to the contract must be tested for impairment.

Breach of covenants

The following circumstances, for example, either individually or collectively, could cause a significant deterioration of financial performance and financial ratios, which may in turn lead to a breach of debt covenants:

- a decrease in customer demand;
- a disruption in production or supply;
- an impairment loss caused by doubts about the recoverability of financial or non-financial assets that lead to impairment losses;

- a decrease in the market price of investments held; or
- an increase in the provision for certain obligations – e.g. those arising from onerous contracts or restructuring plans.

The financial impact of the virus might cause some entities to breach covenants on borrowings or trigger material adverse change clauses. This could result in loan repayment terms changing and some loans becoming repayable on demand resulting in the need to classify the liability as current. This is because the entity does not have an unconditional right to defer its settlement for at least 12 months after that date. [IAS 1.74]. However, if by the reporting date the entity obtains from the lender an agreement to provide a grace period ending at least 12 months after the reporting date, then the liability is classified as non-current. [IAS 1.75]

Entities should consider whether the classification of loans and other financing liabilities between noncurrent and current is affected and in extreme situations whether the entity remains a going concern. Entities should consider particularly the impact of any cross-default clauses. The effect of any changes in the terms of borrowings must be considered and waivers obtained after the reporting date should be treated as non-adjusting events.

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).

Other obligations

Provisions IAS 37 Provisions, contingent liabilities and contingent assets, requires a provision to be recognised only where an entity has a present obligation; it is probable that an outflow of resources is required to settle the obligation; and a reliable estimate can be made. Entities' actions in relation to the virus should be accounted for as a provision only to the extent that there is a present obligation for which the outflow of economic benefits is probable and can be reliably estimated.

11.Other Financial Statement Items

Contingent assets

One of the steps taken to control the spread of the virus is to require that some businesses close down temporarily. An entity might have business continuity insurance and be able to recover some or all of the costs of closing down. Entities should consider whether the losses arising from COVID-19 are covered by its insurance policies. The benefit of such insurance is recognised when the recovery is virtually certain. This is typically when the insurer has accepted that there is a valid claim and the entity is satisfied that the insurer can meet its obligations. The benefit of insurance is often recognised later than the costs for which it compensates.

Income taxes

The virus could affect future profits as a result of direct and indirect (effect on customers, suppliers, service providers) factors. Asset impairment may also reduce the amount of deferred tax liabilities and/or create additional deductible temporary differences. Entities with deferred tax assets should reassess forecast profits and the recoverability of deferred tax assets in accordance with IAS 12 *Income taxes* taking into account the additional uncertainty arising from the virus and the steps taken to control it.

Entities should consider whether the impact of the virus affects plans to distribute profits from subsidiaries and whether it therefore needs to reconsider the recognition of any deferred tax liability in connection with undistributed profits. Any significant judgements and estimates made in assessing the recoverability of deferred tax assets, should be disclosed in accordance with IAS 1.

Government assistance in the form of benefits that may impact an entity's taxable profit or its income tax liability – e.g. tax reliefs for certain types of income, additional tax deductions, a reduced tax rate or an extended period to use tax losses carried forward are accounted for under IAS 12 Income Taxes. For example, if a government plans to amend income tax legislation to reduce corporate tax rates, then an entity recognises and measures the effect of the amendment in accordance with the detailed requirements of IAS 12. This includes considering whether any deferred tax assets are recoverable . An entity accounts for the change in tax rate only when the amendment to the legislation is substantively enacted.

Deferred tax assets

Under IAS 12 *Income Taxes,* a deferred tax asset is recognised for deductible temporary differences and unused tax losses (tax credits) carried forward, to the extent that it is probable that future taxable profits will be available. [IAS 12.24, 34]. To determine whether future taxable profits will be available, entities must first consider the availability of qualifying taxable temporary differences, and then the probability of other future taxable profits and tax planning opportunities. In other words, if the entity is loss-making, it can still recognise a deferred tax asset if it has sufficient qualifying taxable temporary differences to meet the recognition test. [IAS 12.28–29, IU 05-14]

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

- changes in forecast cash flows – e.g. expected decrease in production or sales prices vs increase in costs;
- changes in an entity's tax strategies;

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

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

Borrowing costs

Under IAS 23 Borrowing Costs, an entity capitalises borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset – i.e. one that necessarily takes a substantial period of time to get ready for its intended use or sale. If an entity suspends active development of a qualifying asset for an extended period, then it also suspends capitalisation of the borrowing costs for that asset. [IAS 23.20]

The COVID-19 outbreak might force entities to pause physical development projects. Entities need to consider both the expected length and the nature of the suspension when evaluating whether an interruption caused by the COVID-19 outbreak will continue for an extended period.

An entity may continue to capitalise borrowing costs if:

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

Capitalised contract costs

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

Capitalised contract costs are amortised on a systematic basis consistent with the pattern of transfer of the good or service to which the asset relates. The COVID-19 outbreak may affect the expected timing of transfer of the goods or services to the customer. Changes in the amortisation period are treated as a change in accounting estimate under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Government grants and assistance

Government assistance that meets the definition of a government grant is accounted for under the specific requirements of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance.*

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

- Does the assistance meet the definition of a government grant?
- When should the grant be recognised?

- How should the grant be measured and presented in the financial statements?

Government grants

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

Government ownership interests

Government participation in the ownership of an entity is not itself in the scope of IAS 20. For example, if a government acquires an ownership interest in a subsidiary, then the parent entity applies IFRS 10 *Consolidated Financial Statements* to assess whether it should continue to consolidate the subsidiary or, if appropriate, to account for a disposal or partial disposal. If a government provides support to an entity and is also a shareholder in that entity, then the entity needs to assess whether the government is acting in its capacity as shareholder or as government. This will determine how the entity accounts for the government support.

Government loans and guarantees

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

12.Consolidation

Financial statements must present fairly the financial position, financial performance and cash flows of the group. Where subsidiaries, associates or joint ventures are material, all the available sources of the information necessary to prepare financial statements for the group should be considered.

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.

13.Interim Reporting

Entities with calendar year-ends will have to present their 2020 interim reports reflecting the impacts of the COVID-19 coronavirus outbreak in the financial statements.

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

Accounting policies

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.

Many entities may first report the impact of the virus in interim financial statements. Although there may be greater use of estimates, there are typically no recognition or measurement exceptions for interim reporting.

Going concern

The going concern requirements set out in IAS 1:25 and 26 apply to interim financial reports. Therefore, entities 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, entities will need to take into account all information available up to the date of authorisation of the interim financial report.

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

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. Therefore, the challenges described elsewhere in this document will need to be addressed in the same manner

in interim financial statements but will generally require a greater use of estimation methods than annual financial statements.

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 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.

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.

Effective tax rate

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 entities 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. 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.

Tax reliefs

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).

Recoverability of deferred tax assets

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

Disclosures

The interim financial statements should provide an explanation and an update to the relevant information included in the annual financial statements. 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.

IAS 34 requires that an entity shall include in its interim financial report an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period. This implies that additional disclosure should be given to reflect the financial impact of the virus and the measures taken to contain it. This disclosure should be entity specific and should reflect each entity's circumstances.

Where significant, the disclosures required by paragraph 15B in IAS 34 should be included, together with:

- the impact on the results, balance sheet and cash flows of the virus and the steps taken to control the spread;
- significant judgements that were not required previously, for example in connection with expected credit losses;
- updates to the disclosures of significant estimates; and
- events since the end of the interim period.

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

14. Going Concern

IAS 1 *Presentation of Financial Statements* requires management, when preparing financial statements, to make an assessment of an entity's ability to continue as a going concern, and whether the going concern assumption is appropriate. Specific disclosures are required when the going concern basis is not used or when management is aware, in making their assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern.

In assessing whether the going concern assumption is appropriate, the standard requires that all available information about the future, which is at least, but not limited to, twelve months from the end of the reporting period, should be taken into account. This assessment needs to be performed up to the date on which the financial statements are issued.

When entities assess the entity's ability to continue as a going concern, it will need to consider the current economic uncertainty and market volatility caused by the COVID-19 outbreak. For example, for 31 December 2019 reporters that are severely affected by COVID-19, even though the significant impact on operations occurred after year-end, it will be necessary for entities to consider the appropriateness of preparing financial statements on a going concern basis.

The assessment of going concern may need to include:

- assessing availability of finance
- updating forecasts and sensitiveness as considered appropriate, considering risk factors identified and different possible outcomes
- reviewing of projected covenant compliance in different scenarios
- changing management's plans for future actions
- expanding disclosures

Entities adversely affected by the coronavirus, for example small businesses or those in the areas of travel, leisure & hospitality and aviation, need to consider going concern issues. They need to consider running several possible sensitivity analyses to determine whether there is any material uncertainty on its ability to continue as a going concern. This can result in additional disclosures especially if there is a material uncertainty. In some circumstances it may be necessary to consider whether it is appropriate to prepare the accounts on a going concern basis.

It is important to continuously assess and update the going concern assessment to the date the financial statements are approved.

Measurement

Management is required to assess the entity's ability to continue as a going concern. When making that assessment, where relevant, management takes into consideration the existing and anticipated effects of the outbreak on the entity's activities in its assessment of the appropriateness of the use of the going concern basis.

For example, when an entity has a history of profitable operations and relies on external financing resources, but because of the outbreak, its operations have been suspended since January 2020, entities would need to consider a wide range of factors relating to the current adverse situation and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate. Entities should consider all available information about the future which was obtained after 31 December 2019.

The following are examples of things to consider when evaluating going concern:

- The potential impact on the forecasts of future cash flows. In many cases, it is likely that the budgets and projections initially used to support the assessment of the going concern accounting principle have become less relevant given the rapidly changing conditions and may require significant revision to support the assessment made by the entity in the current circumstances.
- Whether forecasts and sensitiveness were updated as considered appropriate, considering risk factors identified and different possible outcomes.
- Whether the assessment of the going concern assumption took into account the expected impacts of the Covid-19 pandemic.
- Whether the entity considered the various government measures that are enacted to support the entities as far as the entity is eligible and intends to engage the necessary requests for economic support.
- Consideration of bank covenants and compliance in different scenarios

Disclosure

Given the unpredictability of the potential impact of the outbreak, there may be material uncertainties that cast significant doubt on the entity's ability to operate under the going concern basis.

The following should be disclosed:

- If uncertainties exist about the entity's ability to continue as a going concern, a clear disclosure should be added in the notes to the financial statements.
- Any key judgment that was applied by management should be disclosed.
- When the use of the going concern basis of accounting is not appropriate in the circumstances, entities may be required, or may elect, to prepare the financial statements on another basis (e.g. liquidation basis in IFRS as going concern issue after the closing date is a specific exception to the non-adjusting events).

15.Subsequent Events

At the end of each reporting period, entities should carefully evaluate information that becomes available after the reporting date but before the issuance of the financial statements.

Depending on an entity's reporting date, the impacts of the COVID-19 outbreak could be adjusting or non-adjusting events. The amounts in the financial statements must be adjusted to reflect events that provide evidence of conditions that existed at the end of the reporting period. Additionally, if non-adjusting events (those that are indicative of conditions that arose after the reporting period) are material, an entity would be expected to disclose the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made.

Reporting periods ending on or before 31 December 2019

- 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 (e.g., 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 most entities with a 31 December 2019 year-end, the emergence of coronavirus is a non-adjusting event, since the outbreak occurred midst of January 2020.
- Although the COVID-19 pandemic would be considered as a non-adjusting event since the conditions did not exist at the closing date, certain existing conditions may need to be revised based on this new development.
- If an event is considered to be non-adjusting, then the nature of the event should be disclosed.
- Where an estimate of the financial effect on the entity can be made, then this should be disclosed. Otherwise the fact that the financial effect cannot be estimated should be disclosed. The estimate does not need to be exact – a range of estimated effects is better than no quantitative information at all. In the absence of any quantitative estimate, a qualitative description should be provided.
- Entities should review the uncertainties as of 31 December 2019 (for existing conditions) and assess whether they have changed in light of the COVID-19 development.
- The nature of any material non-adjusting event and an estimate of its financial effect must be disclosed by way of note. Therefore, entities need to consider the impact of the coronavirus on their business, which will vary according to the specific circumstances in which it operates. This includes that the disclosures articulate potential impact in the next reporting period.
- For material non-adjusting events, entities are required to disclose the nature of the event and an estimate of its financial effect, or a statement that an estimate cannot be made. A non-adjusting event is considered material if it is of such importance that non-disclosure would affect the ability of the financial statements' users to make proper evaluations and decisions.

Reporting periods after 31 December 2019

- The coronavirus would most likely be an adjusting event for any reporting period ending as from 31 January 2020.

- There may be a greater degree of judgement required when identifying the conditions at balance sheet dates after 2019, and therefore assessing whether the developments are adjusting or non-adjusting events.
- For subsequent reporting periods, COVID-19 may affect the recognition and measurement of assets and liabilities in the financial statements.
- The following areas subject to judgement and estimation uncertainty must be reviewed:
  - accounting estimates (including revenue recognition; inventories; income taxes; property, plant and equipment; investments in associates and joint ventures; provisions contingent liabilities)
  - fair value measurements
  - assets impairment
  - expected credit loss assessments
  - hedge accounting
  - other financial statement disclosure requirements.
- Examples of Covid-19 pandemic consequences that may be disclosed in the financial statements are as follows:
  - Decrease in sales and revenues
  - The risk of loss on significant contracts
  - Covenant breaches
  - Renegotiation of debts
  - Incapacity to obtain funding
  - Impact on collection of receivables
  - Production stoppages and closing of plants
  - Store or facility closures
  - No or less deliveries from suppliers
  - Other supply chain interruptions
  - The impact on human capital
  - Restructuring plans
  - Loss of customers or customer traffic
  - The impact on distributors
  - Production delays or limitations
  - Regulatory changes

16. General disclosure requirements

Each relevant accounting standard must be considered to determine the required disclosures. Where there is a financial impact, this may include assumptions made in valuations or sensitivity analyses. Entities should also disclose information about assumptions regarding the future, and other major sources of estimation uncertainty. Where there is no financial impact in the current reporting period, entities should make disclosure of their key assumptions as to why it has not had an impact, if COVID-19 is material.

It is important to disclose significant judgements made in applying accounting policies that have the greatest effect on the financial statements. Depending on the entity's specific circumstances, certain financial statement items may be a source of material judgements and uncertainties that requires specific disclosure applying IAS 1 *Presentation of Financial Statements*.

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.

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

Examples of specific disclosures required include:

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

Take note of the following:

- Ensure that the disclosures appropriately describe the entity's prospects and how financial statements' users might be affected, while recognising the current high degree of uncertainty.
- Consider whether sufficient disclosure was made in respect of financial risks such as credit risk, liquidity risk, currency risk and other price risk, as well as the objectives, policies and processes for managing those risks. Additional disclosures about liquidity risk might be needed where the virus has affected an entity's normal levels of cash inflows from operations or its ability to access cash in other ways such as from factoring receivables or supplier finance.
- If concluded there is no financial impact in the current reporting period, disclosures of key assumptions supporting this should be included.
- Assess whether disclosures made outside of the financial statements are materially consistent with disclosures in the financial statements.

- Assess whether analysis presented in other information on principal risks and uncertainties should be updated.
- Consider any specific local disclosure requirements, for example, those issued by the JSE.

The following are examples of disclosures that were included in financial statements for periods ending 31 December 2019[1].

Example 1: Provider of technology consulting services

The Company's operations may be affected by the recent and ongoing outbreak of the coronavirus disease 2019 (COVID-19) which was declared a pandemic by the World Health Organization in March 2020. The ultimate disruption which may be caused by the outbreak is uncertain; however, it may result in a material adverse impact on the Company's financial position, operations and cash flows. Possible effects may include, but are not limited to, disruption to the Company's customers and revenue, absenteeism in the Company's labor workforce, unavailability of products and supplies used in operations, and a decline in value of assets held by the Company, including inventories, property and equipment, and marketable securities.

Example 2: Supplier of precision-engineered solutions for use in manufacturing and testing

In early January 2020, a human infection originating in China was traced to a novel strain of coronavirus. The virus has subsequently spread to other parts of the world, including the U.S. and Europe, and has caused unprecedented disruptions in the global economy as efforts to contain the spread of the virus have intensified. On March 11, 2020, the World Health Organization officially declared this coronavirus outbreak (also referred to as COVID-19) a pandemic. Our business has been and will continue to be adversely affected by the coronavirus pandemic. Since March 17, 2020, a number of states, including all of the states in which we have manufacturing facilities, have instituted 'shelter-in place' orders as well as guidance in response to the pandemic and the need to contain it. We are carefully reviewing all rules, regulations, and orders and responding accordingly. On March 17, 2020, we temporarily shut down our EMS manufacturing facility in Fremont, California. As of the date of this filing, all of our other manufacturing facilities remain open. If the current pace of the coronavirus pandemic cannot be slowed and the spread of the virus is not contained, our business operations could be further delayed or interrupted. We expect that government and health authorities may announce new or extend existing restrictions, which could require us to make further adjustments to our operations in order to comply with any such restrictions. These adjustments to our operations could include additional facility closures. We may also experience limitations in employee resources. Global supply chains and the timely availability of products have been and will continue to be materially disrupted by quarantines, factory slowdowns or shutdowns, border closings and travel restrictions resulting from the coronavirus pandemic. The adverse effects of the coronavirus pandemic on our business could be material in future periods.

The duration of any business disruption and related financial impact cannot be reasonably estimated at this time but may materially affect our ability to operate our business and result in additional costs. The extent to which the coronavirus pandemic may impact our operating results, financial condition, and cash flows will depend on future developments, which are highly uncertain and cannot be predicted as of the time of this filing, including new information that may emerge concerning the severity of the coronavirus and steps taken to contain the coronavirus or treat its impact, among others.

[1] AICPA Special Report issued 31 March 2020

Example 3: Developer & marketer of medical devices & tests

Going Concern

The Company has incurred net losses and negative operating cash flows since inception. For the year ended December 31, 2019, the Company recorded a net loss of approximately $17.2 million and used approximately $9.1 million of cash in operating activities. As of December 31, 2019, the Company had approximately $12.6 million in cash and cash equivalents and working capital of approximately $13.0 million. The Company has not yet established an ongoing source of revenue sufficient to cover its operating costs and is currently expending funds in research and development activities that are expected to continue to require funding. Management believes the currently available funding will only be sufficient to finance the Company's operations for six to nine months from the date of these consolidated financial statements depending on the timing and extent of the Company's clinical trials.

The ability of the Company to continue as a going concern is dependent on the Company obtaining adequate capital to fund operating losses until it becomes profitable. As the Company is currently not generating revenues, continued timely expenditures on trials is important to bring its product(s) to market as soon as able. Management's plans to obtain such resources for the Company include obtaining capital from the sale of its equity securities, entering into strategic partnership arrangements, potential exercise of outstanding warrants, and short-term borrowings from banks, stockholders or other related parties, if needed. The Company can give no assurances that any additional capital that it is able to obtain, if any, will be sufficient to meet its needs, or that any such capital will be obtained on acceptable terms. The continued spread of COVID-19 and uncertain market conditions may limit the Company's ability to access capital. If the Company is unable to obtain adequate capital, the Company may be required to reduce the scope, delay, or eliminate some or all of its planned commercial activities. These conditions, in the aggregate, raise substantial doubt as to the Company's ability to continue as a going concern. The accompanying consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts and classification of liabilities should the Company be unable to continue as a going concern.

Subsequent Events

The continued spread of the COVID-19 pandemic is affecting the United States and global economies and may affect the Company's operations and those of third parties on which the Company relies, including by causing disruptions in the supply of the Company's Endoxifen and the conduct of current and future clinical trials. In addition, the COVID-19 pandemic may affect the operations of the Food and Drug Administration and other health authorities including similar entities / agencies in Sweden and Australia, which could result in delays in meetings, reviews and approvals, including with respect to the Endoxifen. The evolving COVID-19 pandemic could also directly or indirectly impact the pace of enrolment in the Company's clinical trials for at least the next several months and possibly longer as patients may avoid or may not be able to travel to healthcare facilities and physicians' offices except for a health emergency. Such facilities and offices may also be required to focus limited resources on non-clinical trial matters, including treatment of COVID-19 patients, and may not be available, in whole or in part, for clinical trial services related to Endoxifen. Additionally, while the potential economic impact brought by, and the duration of, the COVID-19 pandemic is difficult to assess or predict, the impact of the COVID-19 pandemic on the global financial markets may reduce the Company's ability to access capital, which could negatively impact the Company's short-term and long-term liquidity. The ultimate impact of the COVID-19 pandemic is highly uncertain and subject to change. The Company does not yet know the full extent of potential delays or impacts on its business, financing or clinical trial activities or on healthcare systems or the global economy as a whole. However, these effects could have a material impact on the Company's liquidity, capital resources, operations and business and those of the third parties on which we rely.

Example 4: Department store operator

Subsequent Events
Effective March 17, 2020, we announced the temporary closure of our stores in the U.S. and Canada for two weeks, including our FLS, Nordstrom Rack stores, Trunk Club clubhouses and Jeffrey boutiques in response to the increased impact from novel coronavirus (COVID-19). We continue to serve customers through our apps and online at Nordstrom.com, Nordstromrack.com, HauteLook and Trunk Club, including digital styling, online order pickup and curbside services at our FLS. While this is expected to be temporary, the current circumstances are dynamic and the impacts of COVID-19 on our business operations, including the duration and impact on overall customer demand, cannot be reasonably estimated at this time and we anticipate this may have a material adverse impact on our business, results of operations, financial position and cash flows in 2020.
As of February 1, 2020, our existing cash and cash equivalents on-hand were $853k and had $800k available on our Revolver, with an option to increase the Revolver by up to $200k, to a total of $1,000k (see Note 9: Debt and Credit Facilities). As a precautionary measure, to increase our cash position and preserve financial flexibility in light of current uncertainty resulting from the COVID-19 outbreak, we drew down $800 on our Revolver in March 2020.

Example 5: Department store operator

In March 2020, the World Health Organization declared the outbreak of a novel coronavirus (COVID-19) as a pandemic, which continues to spread throughout the United States. As a result, we have temporarily closed some retail locations, reduced store operating hours, and have seen a reduction in consumer traffic, all resulting in a negative impact to Company sales. While the disruption is currently expected to be temporary, there is uncertainty around the duration. Therefore, while we expect this matter to negatively impact our business, results of operations, and financial position, the related financial impact cannot be reasonably estimated at this time. As a result, the Company is leveraging its balance sheet and has fully drawn its $1 billion unsecured credit facility to increase its cash position and help preserve its financial flexibility.

Example 6: Manufacturer of tires and synthetic rubber-related products

Subsequent Events
Subsequent to year-end 2019, the World Health Organization declared the novel coronavirus (COVID-19) outbreak a public health emergency. There have been mandates from international, federal, state and local authorities requiring forced closures of various schools, businesses and other facilities and organizations. These forced closures could negatively impact the Company’s business. While the closures and limitations on movement, domestically and internationally, are expected to be temporary, the duration of the supply chain disruption, and related financial impact, cannot be estimated at this time. Should the closures continue for an extended period of time or should the effects of the coronavirus continue to spread, the impact could have a material adverse effect on the Company’s financial position, results of operations and cash flows.

Example 7: Developer of measurement technology

In late 2019, a novel strain of COVID-19, also known as coronavirus, was reported in Wuhan, China. While initially the outbreak was largely concentrated in China, it has now spread to several other countries, including Israel, and infections have been reported globally. Many countries around the world, including in Israel, have significant governmental measures being implemented to control the spread of the virus, including temporary closure of businesses, severe restrictions on travel and the movement of people, and other material limitations on the conduct of business. These measures have resulted in work stoppages and other disruptions. The extent to which the coronavirus impacts our operations will depend on future developments, which are highly uncertain and cannot be predicted with confidence, including the duration and severity of the outbreak, and the actions that may be required to contain the coronavirus or treat its impact. In particular, the continued spread of the coronavirus globally, could adversely impact our operations and workforce, including our marketing and sales activities and ability to raise additional capital, which in turn could have an adverse impact on our business, financial condition and results of operation.

Example 8: Jewelry retailer

In December 2019, COVID-19 was identified in Wuhan, China. In March 2020, the World Health Organization declared COVID-19 a global pandemic as a result of the further spread of the virus into all regions of the world, including those regions where the Company's primary operations occur in North America and the UK. COVID-19 has already begun to significantly impact consumer traffic and the Company's retail sales, based on the perceived public health risk and government-imposed quarantines and restrictions of public gatherings and commercial activity to contain spread of the virus. Effective March 23, 2020, the Company has temporarily closed all of its stores in North America, its diamond operations in New York and its support centres in the United States, and effective March 24, 2020, has temporarily closed all of its stores in the UK. The COVID-19 pandemic has also begun to disrupt the Company's global supply chain, and may cause additional disruptions to operations if employees of the Company become sick, are quarantined, or are otherwise limited in their ability to work at Company locations or travel for business. While the Company's e-commerce business has not yet been significantly impacted, additional federal or state mandates ordering the shut-down of additional non-essential businesses could impact the Company's ability to take or fulfil customer orders placed online.
0In addition, as a result of the uncertainty surrounding the impacts of COVID-19, beginning in February 2020, there was a significant decline in all major domestic and global financial market indicators. The Company's share price and market capitalization has significantly declined and been reduced below its book value as of the date of this report.

The full extent and duration of the impact of COVID-19 on the Company's operations and financial performance is currently unknown, and depends on future developments that are uncertain and unpredictable, including the duration and spread of the pandemic, its impact on capital and financial markets on a macro-scale and any new information that may emerge concerning the severity of the virus, its spread to other regions and the actions to contain the virus or treat its impact, among others.

The Company is currently evaluating the potential short-term and long-term implications of COVID-19 on its consolidated financial statements. The potential impacts to the Company's consolidated financial statements could occur as early as the first quarter of Fiscal 2021, and include, but are not limited to: impairment of goodwill and indefinite-lived intangible assets; impairment of long lived assets, including property and equipment and operating lease right-of-use assets related to the Company's stores; fair value and collectability of receivables and other financial assets (including the deferred purchase price described in Note 21); valuation of inventory; and the hedge de-designation of certain foreign currency and commodity derivative financial instruments should those instruments become ineffective.

Any of these outcomes could have a material adverse impact on Signet's business, financial condition, results of operations and cash flows. Management currently believes that it has adequate liquidity and business plans to continue to operate the business and mitigate the risks associated with COVID-19 for the next 12 months from the date of this report.