COVID-19 FINANICAL REPORTING IMPLICATIONS FOR ACCOUNTING PERIODS ENDING AFTER 31 DECEMBER 2019

BACKGROUND

The coronavirus pandemic (COVID-19) has fast become the defining global health crisis of our time and the greatest challenge to almost all entities, either directly or indirectly. There are significant disruptions to global supply chains, suspension, or in worst cases cessation of many business operations, significant volatility and downturn in financial, commodity and energy markets, unemployment or furloughs, and as a result all industries are facing unavoidable challenges associated with the economic conditions resulting from control measures and restrictions taken by respective governments to limit the spread of the virus.

As the impact of COVID-19 continues to unfold around the globe, the COVID-19 pandemic, and the conditions resulting from the measures taken to contain it have also created significant challenges to preparers and auditors of financial statements. This publication is intended to provide guidance on the key financial reporting considerations arising from COVID-19 and its associated events. The guidance therein relates to financial statements prepared in accordance with International Financial Reporting Standards (IFRS) for accounting periods ending after 31 December 2019.

Given the rapid evolution of the COVID-19 situation and depending on the facts and circumstances of each entity, the resulting impact varies between entities. This publication may not therefore cover all issues potentially applying to all entities.

FINANCIAL REPORTING CONSIDERATIONS

REVENUE RECOGNITION

The impact brought by the COVID-19 pandemic may cause there to be significant uncertainties as to the customer's behaviour, for instance, greater returns due to decreasing demand or delayed payments. On the other hand, management may want to help or maintain its customers by offering concessions or incentives; or revising the existing contract to extend the payment terms. These factors affect the assumptions and estimates made by management in recognising revenue on both new and existing contracts, in particular if the measurement involves variable consideration; such as discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses and penalties.

When there is a variable element of consideration in a contract with a customer, IFRS 15 **Revenue from Contracts with Customers** requires an entity to estimate, at the date of inception of the contract, the amount of consideration to which it will be entitled in exchange for transferring promised goods or services to that customer. It further requires an entity to consider whether it should restrict the estimated amount of consideration to be included in the transaction price, and therefore recognised, to the extent that it is highly probable that cumulative revenue recognised will not be significantly reversed when the uncertainties associated with the variability are subsequently resolved.

Reassessment of the estimated transaction price has to be conducted at the end of each reporting period as required by IFRS 15. If there is a reduction in the estimated transaction price, an entity may need to reverse some of the revenue that had previously been recognised. For example, increasing estimates of expected returns given foreseeable reduction in demand, additional price concessions to customer with financial difficulties, potential penalties for late delivery, lower possibility of meeting the threshold for performance bonus and so forth will potentially reduce the estimated transaction price. Again, this is not an exhaustive list.

To demonstrate that the entity has critically considered whether, and how, to restrict estimates of variable consideration for these or other relevant factors, an entity should maintain sufficient documentation on the significant judgements it applied in making the estimate, for example, the customer's ability to pay, the fulfillment of contractual obligations and so forth. In addition, the entity may need to disclose information about how an entity has applied its policies or actions to tackle the uncertainties arisen from the COVID-19 pandemic in order to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

GOVERNMENT GRANTS

As the COVID-19 outbreak has evolved into a global pandemic, some countries have instituted a series of measures and restrictions to curb transmission of the disease, for example, closure of cinemas, restaurants and other public venues, lockdown, and restricting or prohibiting public events or gatherings. Businesses, especially those in the tourism, hospitality, retail, entertainment, transportation and manufacturing sectors, are being hit hard by these containment measures. Governments have reacted and attempted to support those entities affected by giving grants, loans, subsidies or tax reliefs. Entities receiving such government assistance should carefully analyse the terms and conditions of the relevant reliefs and recognise them as government grants only when they are within the scope of IAS 20 **Government Grants** and there is reasonable assurance that the entity will comply with the conditions attaching to the grant, and that the grant will be received.

Government assistance, such as income tax holidays, investment tax credits, accelerated depreciation allowances and reduced income tax rates, that affect the determination of taxable income or the basis of income tax liability may need to be accounted for under IAS 12 **Income Taxes**.

COVID-19 driven grants are commonly seen in the form of reimbursements of costs that relate to past costs and / or future costs, for example, reimbursement or subsidy of employees' salaries, and such grants should be recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate.

Grants related to income can be recognised in profit or loss either separately or under a general heading such as 'other income' or deducting from the related expense as an accounting policy choice; whereas for grants related to assets, for example, transfer of land or other resources for the use of the entity, management may choose to recognise the grant as deferred income that is recognised in profit or loss on a systematic basis over the useful life of the asset or deduct the grant in calculating the carrying amount of the asset in which case it is recognised in profit or loss over the life of a depreciable asset as a reduced depreciation expense.

LEASES

Entities are experiencing operational disruptions (such as compulsory closure of bars and restaurants) due to the containment measures, leases, in particular those in the hospitality, entertainment and retail sectors, may be renegotiated or the lessor may offer rent concessions to the lessee. Depending on the nature of the concession, lessees and lessors will have to determine how to account for the concession in accordance with IFRS 16 **Leases**.

Management should consider whether the rent concession will result in a lease modification where there is 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.

The volatile market conditions amidst the COVID-19 pandemic may trigger fluctuations in market interest rates and the entity's credit risks (such as the borrowing rate), so when a lease is being accounted for using the lessee's incremental borrowing rate, an entity has to reconsider and reassess an appropriate rate.

It is noteworthy to highlight that, on 17 April 2020, the International Accounting Standards Board (IASB) tentatively decided to provide practical relief to lessees in accounting for rent concessions arising as a result of the COVID-19 pandemic by providing lessees with an optional exemption from assessing whether a COVID-19-related rent concession is a lease modification and account for those rent concessions as if they were not lease modifications. Entities are encouraged to monitor the progress and final decisions. Details of the discussion can be found **here**.

When...	Lessor	Lessee
A rent concession granted by the landlord is given in form of short-term reduction in lease payment that result in a lease modification (i.e. with a change in the consideration of the lease)	• To consider the reallocation of consideration in the contract, reassessment of lease term, liability and lease classification • To apply IFRS 16, para. 79-80 if it is a finance lease and apply para. 87 if it is an operating lease	• To consider the reallocation of consideration in the contract, reassessment of lease term, liability and lease classification • To apply IFRS 16, para. 44-46
A rent concession granted by the landlord is due to contractual obligations or applicable laws governing the contact (i.e. without any lease modification)	• In an operating lease – to recognise the effect of the rent concession by recognising lower income from the lease • In a finance lease - continue to account for the lease under its original terms and conditions, but the carrying amount of the net investment in the lease will be subject to adjustment/ impairment	• To account for as a variable lease payment and recognise in profit or loss when the associated variability is resolved
When a lessee receives compensation from a local government directly	• Not applicable	• To consider whether the compensation received is a government grant in accordance with IAS 20 **Government Grants** and as discussed in the previous section

EMPLOYEE BENEFITS AND SHARE-BASED PAYMENTS

DEFINED BENEFIT OBLIGATIONS

An entity is required to remeasure the present value of defined benefit obligations (and related current service cost) and the fair value of plan assets at the end of each reporting period in accordance with IAS 19 **Employee Benefits**.

The measurement of the defined benefit obligations normally requires the application of an actuarial valuation method involving management estimates and actuarial assumptions, such as discount rate, employee turnover, mortality, expectation on salary increment and so forth.

Given the significant uncertainty linked with the unprecedented COVID-19 situation, it may be challenging for entities to develop reliable estimates and apply appropriate assumptions. Entities should make their best effort to ascertain the impact resulting from the outbreak and its associated events where revision on the estimates and assumptions may be required.

For example, IAS 19 **Employee Benefits** sets out that the discount rate should be determined by reference to market yields at the end of the reporting period on high quality corporate bonds. Alternatively, market yields on government bonds shall be used where there is no deep market in such high quality corporate bonds. Bond prices may be subject to significant decline as a result of the COVID-19 pandemic which management should take into consideration when measuring the defined benefit obligations.

TERMINATION BENEFITS

As the COVID-19 situation continues to evolve, it is forcing corporations to cut budgets and is triggering redundancies/layoffs across different sectors.

An entity should recognise a liability for termination benefits at the earlier of the date when the entity can no longer withdraw the offer of those benefits or the date when the costs for a restructuring is recognised in accordance with IAS 37 **Provisions, Contingent Liabilities and Contingent Assets** and the restructuring involves the payment of termination benefits.

IAS 19, para. 166-167, outlines the criteria under which the entity can no longer withdraw the offer when it has communicated the termination plan to the affected employees:

a). Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made.

b). The plan identifies the number of employees whose employment is to be terminated, their job classifications or functions and their locations (but the plan need not identify each individual employee) and the expected completion date.

c). The plan establishes the termination benefits that employees will receive in sufficient detail that employees can determine the type and amount of benefits they will receive when their employment is terminated.

When measuring the termination benefit, an entity should consider the nature of the employee benefits. If the termination benefits are an enhancement to post-employment benefits, the entity should apply the requirements of IAS 19 for post-employment benefits. Otherwise, depending on the settlement plan of the termination benefits, if it is:

a). expected to be settled wholly before 12 months after the balance sheet date in which the termination benefit is recognised, the requirements for short-term employee benefits should be applied;

b). not expected to be settled wholly before 12 months after the balance sheet date, the requirements for other long-term employee benefits should be applied.

SHARE-BASED PAYMENTS

Share-based payment arrangements typically include non-market or market performance vesting conditions that are linked to an entity's operations, for example, revenue targets, profit growth, successful completion of a public listing and so on. The consequences of the COVID-19 outbreak is likely to lead to changes in the probability of satisfying the vesting conditions for share based payments. IFRS 2 **Share-based Payment** allows recognition of expenses for a share-based payment arrangement with a performance condition only when the outcome of the performance condition is probable and therefore the share-based payment arrangement is considered likely to vest. If it is not probable that the performance condition will be met, and the options or other instruments subject to the share-based payment are no longer likely to vest, then any previously recognised expense should be reversed.

The exception is market-based vesting conditions, for instance achievement of a target share price, which are taken into account in determining the initial grant date fair value of the share-based payment arrangement and are therefore not taken into account when re-measuring the share-based payment expense at each subsequent reporting date.

Some entities may consider it necessary to modify their share-based payment arrangements. If changes are beneficial to the employees affected, entities will need to recognise an additional expense for any incremental fair value granted; however if the changes do not benefit the employees affected, the effect on the changes is disregarded. IFRS 2 provides further guidance in respect of various circumstances.

EXPECTED CREDIT LOSSES

Since expected credit losses (ECL) apply to loans, trade and other receivables, debt securities, contract assets, financial guarantees, loan commitments and so forth, entities should carefully consider the impact of COVID-19 on the ECL where significant judgements and accounting estimates may be involved.

The measurement of ECL is a probability weighted amount that is determined by evaluating a range of possible outcomes, therefore, management should consider the impact on these outcomes as a consequence of the COVID-19 situation at the balance sheet date. All reasonable and supportable information, including forward-looking information, that is available without undue cost or effort at the reporting date should be considered in measuring the ECL.

IFRS 9 **Financial Instruments** requires an entity to measure the impairment loss for a financial instrument at an amount equal to the lifetime ECL when there is a significant increase in credit risk on a financial instrument since initial recognition. If the credit risk on a financial instrument has not increased significantly since initial recognition, an entity should measure the impairment loss for that financial instrument at an amount equal to 12 month ECL at the reporting date. Nevertheless, an entity should always measure the impairment loss at an amount equal to lifetime ECL for assets that subject to the simplified approach, such as trade receivables or contract assets and lease receivables that are within the scope of IFRS 15 and IFRS 16 respectively.

In forming the accounting estimates and preparing the forecasts under the ECL assessment, an entity should take not only the effects of COVID-19, but also the effects of its associated events, for example, the containment or support measures undertaken by the local authorities.

When making the estimation of ECL, management should factor in the impact of COVID-19 on credit risk, probability of default and magnitude of loss given default. For instance, customers experiencing business disruption due to lock down may heighten the credit risk; government subsidies provided directly to corporations may reduce the probability of default; customers deferring payment may increase the probability of default; the decrease in the fair value of collateral and other pledged assets may increase the loss given default. Other factors may also be relevant.

On the other hand, the assumptions and linkages between changes in economic conditions and customer behaviour underlying the exiting ECL models may no longer reflect the information and conditions available in the current environment amid the COVID-19 pandemic. Therefore, management should revisit the existing ECL methodology and make appropriate adjustments to the models based on current judgements where necessary.

IMPAIRMENT OF NON-FINANCIAL ASSETS

The COVID-19 pandemic may have negatively impacted the business operations of entities and triggered an asset Impairment. IAS 36 **Impairment of Assets** requires entities to conduct an impairment test on a non-financial asset if indicators of impairment existed at the reporting date. IAS 36 also specifies that goodwill and intangible assets with an indefinite useful life are subject to impairment test at least annually.

In assessing whether there is any indication that an asset may be impaired, management should consider both the internal and external sources of information.

Below are some examples of impairment indicators:

- Shrinking demand due to adverse change in the economic environment, production lines become idle or not reaching its planned production capacity
- Reducing production capacity due to decreasing exports as a result of country lock down or border closure
- Restructuring plan that led to asset disposals before the previously expected date
- Breach of contracts and loss of customers due to delivery failure or customer's bankruptcy
- Existing doubt about the entity's ability to continue as a going concern
- Assets, such as hotels, commandeered by government causing cessation of services or reduction of utilisation
- Interruptions on supply chain driven to increasing costs

This is not an exhaustive list.

Reasonable and supportable assumptions should be used in impairment testing and the cash flow forecasts which reflect the potential impact of the COVID-19 based on conditions that existed at the end of the reporting date. Cash flow projections, including revenue growth rate and margin, may be significantly affected by the COVID-19 pandemic and its associated events. Management should make professional judgements with reference to all relevant facts and circumstances in making these estimates and develop additional sensitivity analysis to capture extremely severe downside scenarios where applicable.

RESTRUCTURING PLANS

Management may be considering or implementing restructuring plans to cope with plunging revenue and deteriorating cashflows amid the COVID-19 pandemic, such as downsizing operations through redundancies, closure of shops or termination of a line of business.

When an entity has a detailed formal plan for the restructuring at the reporting date and has raised a valid expectation in those affected that it will carry out the restructuring, by starting to implement that plan, or announcing its main features to those affected by it, management should consider recognising a provision for restructuring in accordance with IAS 37 **Provisions, contingent liabilities and contingent assets** if a present obligation is present that an outflow of economic benefits is probable at the reporting date and can be reliably estimated.

GOING CONCERN

IAS 1 **Presentation of Financial statements** requires management to assess the entity's ability to continue as a going concern and to take into account all available information about the foreseeable future, which is at least, but not limited to, 12 months from the end of the reporting period (in some jurisdictions a longer period of assessment is required, for instance in the United Kingdom the period required is 12 months from the date on which the financial statements are authorised for issue). When assessing the entity's ability to continue as a going concern, management should consider the potential implications of COVID-19 and the control measures taken.

The COVID-19 pandemic and and the measures taken to mitigate it from spreading may have a negative impact on both the profitability and cash flows of an entity. When making a going concern assessment, an entity should specifically consider whether the COVID-19 pandemic and its associated measures cause disruption to business operations, decrease customer's demand, or lead to breaking of bank covenants or contractual obligations, which in turn leads to liquidity problems or operational difficulties for the entity that hinders the entity continuing to operate on a going concern basis.

The going concern basis of preparation will, however, still be used unless the entity either intends to liquidate or cease trading, or has no realistic alternative other than to do so. Where the going concern basis is used, but there are material uncertainties as to whether the entity is a going concern, this is required to be disclosed.

SUBSEQUENT EVENTS

As the COVID-19 situation continues to evolve at a rapid pace, an entity should consider if there are any events that have occurred between the end of the reporting period and the date the financial statements are authorised for issue that have a material impact on the financial statements, and whether they are adjusting or non-adjusting in nature in accordance with IAS 10 **Events after the Reporting Period**.

There is no specific point in time at which an identified event is adjusting or non-adjusting event, management should assess and determine each identified event based on the conditions that existed at the end of the reporting period, the entity's specific circumstances, and the environment in which the entity operates.

REMINDERS

It is important for entities to monitor the development of COVID-19 and consider local laws, regulations and guidance, as there may be different requirements in different jurisdictions that need to be followed. Various regulators and professional bodies have issued public statements and guidance in the context of the COVID-19 pandemic in the current environment, entities should also take these into consideration.

OTHER RELEVANT GUIDANCE

REGULATORS AND PROFESSIONAL BODIES

- IFAC: The Financial Reporting Implications of COVID-19
- IASB: Accounting for Expected Credit Losses Applying IFRS 9 Financial Instruments in the Light of Current Uncertainty Resulting from the COVID-19 Pandemic
- IASB: Supplementary IASB Update April 2020 — impact of COVID-19
- IASB: Application of IFRS 16 in the light of the COVID-19 Uncertainty
- ICAEW: IFRS9: Helping Banks Support Households and Businesses
- ICAEW: Webcast on Post Balance Sheet Events on COVID-19
- ESMA: Guidance on Accounting Implications of COVID-19

MOORE ARTICLES AND PUBLICATIONS

- Valuation Considerations Amid the COVID-19 Crisis
- Coronavirus: The Potential Financial Reporting Implications for the Year Ended 31 December 2019

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