



RSM INSIGHTS: CORONAVIRUS AND IFRS FINANCIAL REPORTING IMPLICATIONS

by RSM IFRS Advisory Committee

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It's quite clear that coronavirus is a devastating, exceptional and extraordinary worldwide event which will have a significant financial impact on many entities.

The financial reporting implications of coronavirus, together with the Government support, could prove challenging.

We have provided analysis on a number of areas detailing:

- what IFRS says;
- the practical impact and interpretation for preparers of financial statements; and
- our advice to entities.

Whilst the articles will inform accounting work they have been written in the generality – each entity will have unique issues which must also be considered.

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1. OVERARCHING PRINCIPLES

1.1 Accounting estimates and areas of judgement

The outbreak of coronavirus could have a significant effect on the assumptions, estimates and accounting judgements entities take, which will then need to be reflected in the disclosures.

This could impact reporting dates ending before as well as after the emergence and spread of coronavirus, for example, where critical judgements have been exercised in determining whether post balance sheet events are adjusting or not, or whether accounts should be prepared on a going concern basis.

What does IFRS say?

Entities reporting under IFRS must provide disclosures in their financial statements regarding key assumptions concerning the future, and other key sources of estimation uncertainty and significant accounting judgements.

“An entity shall disclose, along with its significant accounting policies or other notes, the judgements, apart from those involving estimations (see paragraph 125), that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.”

(IAS 1.122)

“An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of:

(a) their nature, and

(b) their carrying amount as at the end of the reporting period.”

(IAS 1.125)

Practical impact and interpretation for preparers

Significant accounting judgements

Disclosure of the most important judgements helps users of financial statements to understand how accounting policies have been applied and to make comparisons between entities. Accordingly, such disclosures are most useful when they are not 'boilerplate' and explain clearly the most important judgements made.

Examples of significant accounting judgements that might arise and require disclosure as a result of the impact of coronavirus are:

- going concern considerations, including significant judgement exercised in assessing the existence of any material uncertainties;
- judgement exercised to determine if an event in the series of coronavirus related events provides evidence of a condition existing at the reporting date for the entity's activities, or their assets and liabilities. This could be critical, as per the example in IAS 10.9, when assessing if financial assets should be credit-impaired at the reporting date as a result of a customer going into liquidation after the reporting date; and
- judgement exercised to assess whether a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events, not wholly within the control of the entity, should be disclosed as a 'contingent asset' or recognised as an 'asset'. eg coronavirus related insurance claim.

Key assumptions concerning the future, and other key sources of estimation uncertainty

Determining the carrying amount of some assets and liabilities requires estimation of the effects of uncertain future events eg in the absence of recently observed market prices, future-oriented estimates are necessary to measure: the recoverable amount of classes of property, plant and equipment; the effect of technological obsolescence on inventory; provisions subject to the future outcome of litigation in progress; and defined benefit pension obligations.

These estimates involve assumptions about such items as the risk adjustment to cash flows or discount rates, future changes in salaries and future changes in prices affecting other costs.

The assumptions and other sources of estimation uncertainty to be disclosed relate to the estimates that require management's most difficult, subjective or complex judgements. Those judgements become more subjective and complex as the number of variables and assumptions affecting the possible future resolution increases. The potential for a consequential material adjustment to the carrying amount of assets and liabilities normally increases accordingly.

Disclosure is not required for assets or liabilities that are measured at fair value based on a quoted price in an active market for an identical asset or liability (even if there is a significant risk that their carrying amounts might change materially within the next financial year) because these changes would not arise from assumptions or other sources of estimation uncertainty at the end of the reporting period.

Disclosures should be presented in a manner that helps users of the financial statements to understand the assumptions management makes about the future and about other key sources of estimation uncertainty. The nature and extent of the information to be disclosed will vary according to the nature of the assumptions and the other circumstances.

IAS 1 includes examples of the types of disclosures on judgements about the future and other sources of estimation uncertainty:

- the nature of the assumption or other estimation uncertainty;
- the sensitivity of the carrying amounts of assets and liabilities to the methods, assumptions and estimates underlying their calculation, including the reasons for the sensitivity;
- the expected resolution of an uncertainty and the range of reasonably possible outcomes within the next financial year in respect of the carrying amounts of the assets and liabilities affected; and
- an explanation of changes made to past assumptions concerning those assets and liabilities, if the uncertainty remains unresolved.

It is not necessary to disclose budget information or forecasts in making these disclosures.

It may be impracticable to disclose the extent of the possible effects of an assumption or another key source of estimation uncertainty at the end of the reporting period. The entity should consider disclosing that it is reasonably possible that outcomes within the next financial year will be materially different from the assumptions and could require a material adjustment to the carrying amount of the affected asset or liability. In all cases, the nature and the carrying amount of the specific asset or liability (or class of assets or liabilities) should be disclosed under IAS 1.

Examples of key assumptions concerning the future, and other key sources of estimation uncertainty, that might require disclosure include:

- the measurement of value in use for the purpose of determining impairment of non-financial assets;

- the assessment of future profits to measure deferred tax assets recognised in financial statements;
- fair value measurement of financial assets, where fair value is not based on prices quoted on an active market for an identical asset;
- fair value measurement of investment properties or property, plant and equipment accounted for under the revaluation model;
- the assessment of selling prices for the purpose of inventory impairment calculations; and
- the measurement of provisions, for example, onerous contracts or restructuring provisions.

Our advice

Judgements, estimates and disclosures are going to be more complicated and take time to prepare so it is advisable to start early.

Management should set out the judgements and estimates they normally make and additionally those arising from coronavirus so that these can be incorporated into the accounts. These should be specific to the entity and not boilerplate.

There is increased risk that the carrying amounts of various assets and liabilities may require material adjustments within the next financial year. All entities should carefully consider whether additional disclosures are necessary in order to help users of financial statements understand the judgement applied in their financial statements.

1.2 Going concern

The coronavirus pandemic will have far reaching micro and macro implications which will require businesses of all sizes to reassess their budgets and forecasts to consider the impact on their going concern basis and accounts disclosure.

What does IFRS say?

An entity adopts the going concern basis of accounting unless management either intends to liquidate the entity or to cease trading or has no realistic alternative but to do so. Disclosure is required of any material uncertainties which may cast significant doubt over the going concern status. Management must also disclose significant judgements, so even if there are no material uncertainties disclosure may still be required.

Practical impact and interpretation for preparers

The assessment of whether an entity has the ability to continue as a going concern is likely to be one of the most significant judgements management need to make in the current climate. Even if there are no material uncertainties, which may cast significant doubt on the entities ability to continue as a going concern, entities should document the judgements made in the assessment and detail them in the accounting policies.

As such there is a presumption of disclosure around going concern in small, medium and large entities accounts.

Our advice

- Entities should continue to prepare their short, medium- and long-term forecasts, flexed for various scenarios to assess the cash requirements of the business and their headroom within available facilities. Dependent upon the outcome of these forecasts, they should consider what additional financial assistance maybe required during this time.
- Forecasts should be continually assessed as the conditions around the pandemic evolve and the assumptions previously used may no longer be accurate or valid.
- Disclosure should be presumed to be required in all annual accounts – either of the material uncertainties, or why the entity believes there are none. Entities should start with the macro-economic conditions, how they affect the entity, what they have done about them, and their conclusion why they consider using the going concern basis of preparation is appropriate.

1.3 Events after the reporting date

Coronavirus is likely to impact on the recognition and disclosure requirements for events after the reporting date.

What does IFRS say?

IAS 10 *Events after the Reporting Period* governs the recognition and disclosure requirements for events after the reporting date. The key question for preparers and auditors of financial statements will be whether, and to what extent, the effects of coronavirus represent adjusting or non-adjusting events.

Adjusting events “provide evidence of conditions that existed at the end of the reporting period,” whereas non-adjusting events “are indicative of conditions that arose after the end of the reporting period.”

Amounts recognised in the financial statements are adjusted for adjusting events, but not for non-adjusting events. However, the numerical effects of non-adjusting events still need to be quantified for inclusion in the required disclosures unless an estimate of the financial effect cannot be made, and that fact is stated.

A decision after the reporting date that the entity will liquidate or cease trading either by choice or out of necessity is always treated as an adjusting event and results in the financial statements being prepared on a non-going concern basis. This article discusses events which do not affect the going concern assumption.

Practical impact and interpretation for preparers

Most commentators, including RSM, agree that if entities have a reporting date after the WHO declared coronavirus a global pandemic on 11 March 2020, it is reasonable for the effects of coronavirus to be treated as adjusting events.

Up to 11 March 2020 the situation has been evolving in different countries at differing times, so entities which have a reporting date before then will have to exercise judgement. It is generally accepted the impact of coronavirus is unlikely to be considered a factor that would have a material effect on the measurement of assets and liabilities and therefore would not be an adjusting event for entities with a 31 December 2019 reporting date.

If a UK entity has a reporting date of 31 January 2020 and its principal customer in China became bankrupt in April 2020 because of the effects of coronavirus, management may conclude that the conditions existed prior to the reporting date and recognise the impairment of the debtor balance in this year’s financial statements in line with the treatment for adjusting events. If that same principal customer was in France, management may not be able to use coronavirus to justify the same treatment on the basis that very few cases had been confirmed outside of China at 31 January 2020.

The judgement over whether related events are treated as adjusting or non-adjusting could have a significant effect on the amounts recognised in the financial statements and a detailed disclosure should be provided to state the conclusion and its effect.

For adjusting events there is no explicit disclosure requirement, however, the general requirement to include information which is material to the users of the financial statements, including significant judgements, still applies and if the effects are material then disclosure should be provided.

For non-adjusting events, the nature of the event and the estimated financial effect of the event should be disclosed. In many cases there will be uncertainty over what the financial effects of coronavirus are likely to be, however management should attempt to estimate this, and may find it useful to include a range of outcomes and should not simply disclose that they are unable to quantify the financial effect of the adjustments.

Waivers of loan covenant breaches received after the year end are non-adjusting post balance sheet events. This may mean entities that have breached loan covenants at the reporting date find their long term bank loans are reclassified to short term (with a clear impact on net current assets/liabilities) despite obtaining a waiver or adjustment to the bank facility from the lender in the post year-end period. The waiver would be disclosed as a non-adjusting event and taken into consideration as part of the going concern assessment.

In reviews of corporate reporting regulators have consistently concluded that these disclosures should not be 'boiler-plate' and should assist the user in understanding what the effect of making the alternative judgement would be. Preparers should consider carefully whether the effects on an entity are sufficiently material to require disclosure. If so, it may be necessary to delay publication of the financial information until more reliable estimates of the financial effect can be made.

Our advice

- Entities must review post balance sheet events to determine which are adjusting and which are non-adjusting.
- Disclosure of the judgements involved as well as the events themselves will be crucial.
- Entities should review their loan covenants to assess whether loans require to be reclassified, and then whether they can obtain a waiver which would be disclosable, but non-adjusting.

1.4 Dividends and other distributions

During the coronavirus pandemic, due to the uncertainty of future trading and potential deterioration of financial position from the last annual accounts, entities looking to pay dividends or make other distributions will need to be especially aware of their legal obligations and fiduciary duties, including considering additional factors than they may previously have needed to.

Practical impact and interpretation for preparers

It is important that companies do not assume that distributable profits that existed at the most recent balance sheet date still exist, as distributable profits could have been subsequently lost through the financial effects of coronavirus, for example through impairment of assets, provisions against doubtful debts, restructuring provisions etc.

If distributable profits have been eroded, and a distribution is made, the distribution would be unlawful as it would now be made out of capital and legal advice should be sought to consider the implications.

It's important to consider whether the laws and regulations in respect of distributions apply to payments in respect of shares classified as liabilities, as they do to shares classified in equity. The

ability to pay dividends on preference shares, for example, might still be determined by reference to distributable profit even if those dividends are reported as an interest expense.

Directors should consider any local capital maintenance or solvency requirements before recommending or paying a dividend. This decision needs to be taken in light of the uncertainty presented by coronavirus and the ensuing financial pressures on the company. With some companies operating at reduced levels due to reduction in customer demand or supply-chain disruption, the requirements for cash preservation are likely to be the company's top priority.

In the context of fair value accounting, volatility is an aspect which directors will need to consider. The fair value of financial instruments may be volatile even though such fair value is properly determined in accordance with accounting standards. Directors should consider whether it is prudent to distribute profits arising from changes in the fair values of financial instruments considered to be volatile, even though they may otherwise be determined to be distributable profits.

Our advice

- Ensure management information is updated to the date of the proposed dividend, and date of payment, to confirm that sufficient distributable profits are available to support the distribution.
- Consider any additional adjustments that might be required as a result of coronavirus to management information that are not part of the regular monthly reporting cycle e.g. impairment of assets, additional provisions etc.
- Management will need to consider whether any gains or losses arising as a result of transactions undertaken to mitigate the effects of coronavirus, such as capital contributions and waivers of intra-group debt affect the company's distributable profits. If transactions have resulted in unrealised profits, then sufficient records should be kept so that profits can be distinguished between those that are available for distribution and those that are not.
- Prepare projections that consider how the company will pay its debts due in the months after the proposed dividend to ensure that sufficient cash is available.
- Review regular payments of dividends on preference shares classified as a liability that may be treated as an interest expense or equity dividends to ensure these are not being made out of capital and therefore be unlawful.
- Where dividends have been proposed but not paid, directors should consider whether payment should now be made given changes in the company's financial position. If a company has declared a dividend which has not been paid and the directors now wish to cancel it, they should seek legal advice based on the specific facts and circumstances.
- In group situations, consider what cross-guarantees are in place that may have an impact on the liquidity and distributable profits of the entity making a distribution.
- It is important that proposed distributions are considered on a legal entity basis rather than by reference to the financial position of a consolidated group.

2. PROFIT AND LOSS

2.1 Unusual items and alternative performance measures

The number and size of unusual, albeit not necessarily non-recurring, items that will need to be recognised and presented in the income statement due to coronavirus are likely to be substantial.

What does IFRS say?

IAS (1.97) states that when items of income or expense are material, an entity shall disclose their nature and amount separately, which builds on the requirement of IAS 1.29 to present separately each material class of similar item, ensuring dissimilar items are not aggregated unless immaterial.

Materiality can be determined by reference to an item's size or nature or both.

An entity should not, as a general principle, offset items of income and expense unless permitted or required by an IFRS, eg unless offsetting reflects the substance of the transaction. (IAS 1.32-33)

IAS (1.98) provides specific circumstances that would give rise to separate disclosure of items of income and expenditure which include:

- write downs of inventories to net realisable value or property plant and equipment to recoverable amount;
- restructuring activities and reversals of any provisions for the costs of restructuring;
- disposals of property plant and equipment, investments;
- discontinued operations;
- litigation settlements; and
- other reversals of provisions.

In addition, an entity shall present additional line items, headings and subtotals in the statements presenting profit or loss and other comprehensive income, when such a presentation is relevant to an understanding of the entity's financial performance. (IAS 1.85)

An entity shall not present any items of income or expense as extraordinary items, in the statement of comprehensive income or the separate income statement (if presented), or in the notes. (IAS 1.87)

Practical impact and interpretation for preparers

Entities will clearly wish to separately identify and present the financial impact of dealing with coronavirus on their results and where these are material, IFRS states these should be disclosed on either the face of the income statement or in the notes to provide transparency to the users of the accounts.

As IFRS does not define what items are 'unusual', judgement is required to determine what is considered to be included however any material item of income or expense directly related to the coronavirus pandemic is likely to be deemed unusual and therefore could be separately presented and disclosed.

As outlined above, income and related expenses generally should not be offset. Management will need to consider whether offsetting coronavirus related income and costs in the income statement, and then analysing out the net figure in the notes will provide sufficient and reliable information to users.

There is also flexibility in terms of adding line items, alternative performance measures (APMs) and formatting options e.g. sub-totals on the income statement, however entities should be careful when

exercising their presentation choices, develop detailed accounting policies and ensure consistent application of such policies with full and transparent disclosures. Those that adopt a functional presentation should avoid mixing presentation of items by function and by nature when presenting unusual items related to coronavirus separately.

Entities should ensure the APMs have clear and accurate labelling, their relevance and use is explained, they are reconciled to and not given more prominence than the closest IFRS measure. Additionally, the APMs should be consistent, with an explanation as to why any new APMs provide 'reliable and more relevant information'. Regulators have also warned against the use of normalised or pro-forma results which seek to exclude the effects of Coronavirus to arrive at a hypothetical 'third column income statement presentation'.

An entity may also have exceptional income, such as income from government assistance. Such income will not be revenue and ought to be presented as set out in the article on accounting for the [government assistance](#).

Companies are encouraged to group the 'exceptional or similar' costs and income into a single note or linking them through cross-references so that the whole picture is shown in an even handed and helpful way. Regulators have also warned against:

- describing amounts as 'non-recurring' or one-off if they are also expected to arise in future periods;
- disclosing stranded, sunk or excess costs as exceptional solely because of a reduction or elimination of the related revenue streams; and
- identifying incremental costs as exceptional if they result in incremental revenue that is not also described as exceptional, eg additional staff costs related to unusually high internet sales.

As well as the income statement presentation, a note to the accounts should be included to provide details about the nature and amount of each unusual item. In this note the type of expense in aggregate could be shown eg restructuring costs or write down of property, plant and equipment, and this note could also show the overall impact on the results for the year.

Our advice

- Consider what profit or loss items are material in respect of coronavirus by reference to their size or nature.
- Decide on an income statement presentation and supporting notes that will provide users of the accounts with a clear analysis of the impact of coronavirus on their performance during the period.
- Ensure the impact and actions taken as described in the narrative reporting are consistent with the figures and explanation presented in the financial statements.

2.2 Revenue recognition

Coronavirus is likely to have an adverse impact on the demand for goods and services as well as disrupting supply chain cycles. The knock-on impact could result in customers being unable to pay for goods or services which may affect the way revenue from contracts with customers is recognised in the financial statements.

What does IFRS 15 *Revenue from contracts with customers* say?

IFRS 15 'Revenue from contracts with customers' sets out a single framework for revenue recognition. Its core principle is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange.

IFRS 15 sets out five steps to be followed:

1. Identify the contract(s) with the customer

A contract is within scope only when all the following criteria are met:

- the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;
- the entity can identify each party's rights regarding the goods or services to be transferred;
- the entity can identify the payment terms for the goods or services to be transferred;
- the contract has commercial substance (ie the risk, timing or amount of the entity's future cash flows is expected to change because of the contract); and
- it is probable that the entity will collect the consideration to which it will be entitled.
 - In evaluating whether collectability of an amount of consideration is probable, the entity should consider only the customer's ability and intention to pay that amount of consideration when it is due.
 - The amount of consideration may be less than the price stated in the contract if the consideration is variable eg the entity offers a price concession.

2. Identify the performance obligations

A performance obligation is a promise to provide a distinct good or service, or a bundle of distinct goods or services. IFRS 15.22 requires the assessment and identification of goods and services at the inception of the contract and identification of which promises are performance obligations.

3. Determine the transaction price

The transaction price is the amount of consideration to which the entity expects to be entitled in exchange for transferring promised goods or services to a customer. This may include fixed amounts, variable amounts or both.

Things to consider when determining the transaction price:

- Variable consideration should only be included to the extent that it is highly probable that a significant reversal of cumulative revenue recognised will not occur when the uncertainty is subsequently resolved.
- Constraining estimates of variable consideration. Factors increase the magnitude and likelihood of a change in estimate and a constraining variable consideration include:
 - ✓ the amount of consideration is highly susceptible to factors outside the entity's influence;
 - ✓ uncertainty about the amount of consideration is not expected to be resolved for a long period of time;
 - ✓ the entity's experience (or other evidence) with similar types of contracts is limited, or that experience (or other evidence) has limited predictive value;
 - ✓ the entity has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts; and
 - ✓ the contract has a large number and broad range of possible consideration amounts.
- The existence of a significant financing component in the contract should be considered if payments agreed by either party provide one of the parties with the benefit of financing (either explicit in the contract or implied by the payment terms).
- Non-cash consideration; and

- Consideration payable to a customer.

4. Allocate transaction price to performance obligations

The allocation of transaction price to performance obligations is:

- based on the stand-alone selling price for each distinct good and service. If an entity does not sell the good or service separately, then the stand-alone selling price should be estimated; and
- completed at the inception of the contract and should not be reallocated subsequently to reflect changes in stand-alone selling prices. If a customer receives a discount, this is typically allocated to all the performance obligations based on their relative stand-alone selling prices.

Variable consideration is generally allocated to all performance obligations in a contract based on their relative stand-alone selling prices.

5. Recognise revenue when (or as) the entity satisfies a performance obligation

Revenue is recognised when (or as) a performance obligation is satisfied by transferring control of a promised good or service to a customer.

Revenue is recognised over time in a pattern that reflects the transfer of control of the promised good or service to the customer if:

- the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs;
- the entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or
- the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

An entity is required to select a single method of measuring progress for each performance obligation and apply that consistently.

If none of the above criteria in IFRS 15.35 are met, the performance obligation is satisfied at a point in time. This requires judgement of when control has passed to the customer and hence when revenue should be recognised.

Practical impact and interpretation for preparers

Identification of contract with the customer

An entity recognises revenue only if the contract passes the contract existence test in IFRS 15. Entities will need to carefully consider the degree of uncertainty associated with the collection of the consideration in exchange for the goods or services. In the current climate, it may no longer be probable that consideration will be collected so the contract will not meet all the criteria for recognition.

If a new contract with a customer does not meet all of the contract existence criteria, no revenue should be recognised, and the entity should continue to assess the contract to determine if the criteria have been subsequently met.

Entities may need to reassess whether the contract existence criteria continue to be met for existing contracts and if not then an entity should stop recognising revenue for that contract.

This assessment is undertaken on the basis of available evidence when the financial statements are prepared, based on the conditions that existed at the balance sheet date. It may no longer be

probable that the economic benefits will flow to the entity until the consideration is received, or the uncertainty associated with coronavirus is removed.

Where uncertainty arises about the collectability of an amount that has already been recognised in revenue, any resulting provision is recognised as an expense and not a reduction in revenue.

Entities which have a reporting date between the first noted case of coronavirus on 17 November 2019 and the announcement of coronavirus as a global pandemic on 11 March 2020 will also need to consider the [events after the reporting period](#) requirements.

Identifying performance obligations

If any discounts or offers in respect of future sales provide a material right to the customer, the customer in effect pays the entity in advance for future goods or services. This is a separate performance obligation and an element of the transaction price should be allocated to this performance obligation. The entity recognises revenue when those goods or services are transferred or when the option expires.

Transaction price

There could 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. For example, reduced demand could lead to an increase in expected returns, additional price concessions, reduced volume discounts, penalties for late delivery or a reduction in the prices that can be obtained by a customer. All of these could affect the measurement of variable consideration.

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. coronavirus may mean that the conditions that made it highly probable that there would not be a reversal are no longer met, and that variable revenue should not continue to be recognised.

Additionally, some contracts contain penalties for late performance, due to the current situation the likelihood of late performance may have increased. It is necessary under these circumstances for the penalties to be factored into the transaction price and the revised amount to be recognised as the entity performs.

Satisfaction of performance obligations

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

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

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

Contract modifications

Changes in the economic activity caused by the pandemic will cause many entities to renegotiate the terms of existing contracts and arrangements.

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 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.

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.

Contract assets

Incremental costs are costs incurred that would not have been incurred if the contract had not been obtained, eg sales commission. Under IFRS 15, costs to fulfil a contract with a customer, that are not in the scope of another standard, should be recognised as an asset if the costs meet all the recognition criteria in IFRS 15.95, including an expectation that the costs are recoverable.

The impact of coronavirus means that these costs may no longer be recoverable from the customer and it would therefore not be appropriate to recognise a contract asset. An impairment charge may be required.

Our advice

- Consider whether a new contract with a customer meets all of the contract existence criteria. If it does not, then revenue cannot be recognised.
- Reassess whether the contract existence criteria continue to be met for existing contracts ie if there is a significant change in facts and circumstances. If an existing contract with a customer no longer meets the criteria in IFRS 15.9, then an entity stops recognising revenue for that contract.
- Reconsider the estimate of variable consideration which may change how much revenue can be recognised.
- Consider whether extension of credit terms gives rise to financing transactions.
- Consider whether any contract modifications have arisen as a result of renegotiating existing contracts.
- Consider whether the criteria for recognising revenue over time are still met. Where they are not, revenue will have to be recognised at a point in time which may change the profile of revenue recognition.
- Review contract assets to ensure that they are recoverable. Consider whether there is any impairment required.

2.3 Accounting for government grants

This article covers the recognition, measurement and presentation of both the grants and the related costs in accordance with IFRS.

Please refer to coronavirus and IFRS articles: '[accounting for tax](#)' and '[provisions, onerous contracts and insurance recoveries](#)', the latter explaining that provisions for future operating losses (eg for furloughed staff) are generally not recognised.

What does IFRS say?

Accounting treatment of government grants

A government grant is not recognised until there is reasonable assurance that the entity will comply with the conditions attaching to it, and that the grant will be received. (IAS 20.7) It is important to note that receipt of the grant does not of itself provide conclusive evidence of entitlement. (IAS 20.8)

Grants don't need to have been applied for at the reporting date in order to be booked in the accounts – the entity only needs to have reasonable assurance that the grant claim will be successful and relate to the period in question. By the time the accounts are finalised, this should have been ascertained to provide evidence of the conditions that existed at the reporting date.

If the conditions are met, the grant is recognised in profit or loss in one of two ways:

- 1) 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 (IAS 20.12); or
- 2) in the period in which it becomes receivable where it relates to compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs. (IAS 20.20)

Presentation

IAS 20 permits two methods of presenting government grants in the statement of financial position when the grant is received in relation to an asset (either as deferred income or deducting the grant in calculating the carrying amount of the asset).

Within profit or loss, grants related to income can be presented:

- 1) either separately or under a general heading such as 'other income'; or
- 2) as a deduction in reporting the related expense. (IAS 20.29)

It will be a matter of management judgement as to whether to offset the grant income and related expenditure, and a more convincing argument can be made for offsetting where the expenditure would not have been incurred had it not been for the grant income as described in IAS 20.30. Nevertheless, disclosure of the grant may be necessary for a proper understanding of the financial statements.

Disclosure

IAS 20.39 states that an entity shall disclose the following:

- (a) the accounting policy adopted for government grants, including the methods of presentation adopted in the financial statements;
- (b) the nature and extent of government grants recognised in the financial statements and an indication of other forms of government assistance* from which the entity has directly benefited; and
- (c) unfulfilled conditions and other contingencies attaching to government assistance that has been recognised.

Where grants relate to income, IAS 20.31 suggests that:

- a) disclosure of a grant may be necessary for a proper understanding of the financial statements; and
- b) disclosure of the effect of the grant on any item of income or expense that is required to be disclosed separately is usually appropriate.

* government assistance is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria eg free technical or marketing advice and the provision of guarantees.

Practical impact and interpretation for preparers

For grant income, the terms of the grant, and whether it relates to assets or income, will determine how and when the grant income is recognised.

After determining if the grant should be recognised, and over which period, the entity will need to consider:

- a) For grants related to assets whether to use the:
 - i. net presentation – deduct the grant from the cost of the asset
 - ii. gross presentation – present the grant separately as deferred income to be amortised over the useful life of the asset
- b) For grants related to income – whether to offset the grant against the related expenditure or include it in other income.

Accounting treatment of related costs

Costs which are supported by grants are expensed as incurred (ie no different than before). Any costs which would have been capitalised as part of a construction project must cease when construction is suspended.

The presentation and classification of staff costs, for example, should remain consistent within profit or loss unless another presentation or classification would be more appropriate following a significant change in the nature of the entity's operations (IAS 1.45). Any such change should be considered against IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors ie the change provides more useful information to users of the accounts.

Disclosure of the change would be required under IAS 1.41 where comparatives have been reclassified. When reclassification is impracticable, disclosures as to the reason for not reclassifying and the nature of the adjustments that would have been made had the comparatives been reclassified are required under IAS 1.42.

Our advice

- Entities should prepare a schedule of the government assistance that they are or will be receiving to ensure all are accurately reflected in the accounts. This should include relevant backup to support any claim.
- Entities must review the terms of any grants or assistance to determine the amount that was due to them at the year end, and when to recognise that income i.e. whether it compensates expenses already incurred or future costs.
- Entities must select an accounting policy for coronavirus related grant income, by choosing whether to offset the grant against the related expenditure or to include it in other income.
- Entities should consider whether other forms of additional government assistance will affect the recording of income or expense.

2.4 Holiday pay accruals

One of the range of possible government measures to support entities employing key workers during coronavirus might be an extension of the window that employees can take their annual leave. IAS 19 'Employee Benefits' requires entities to accrue for any short-term employee benefits.

What does IFRS say?

IAS 19 requires entities to accrue for any short-term employee benefits.

This means that entities build up accruals for the undiscounted cost of any unused paid annual leave if it is expected to be settled wholly before 12 months after the end of the reporting period. This is commonly known as a "holiday pay accrual".

Short-term employee benefits (if expected to be settled wholly before 12 months after the end of the annual reporting period in which the employees render the related service) include items such as:

- wages, salaries and social security contributions;
- paid annual leave and paid sick leave;
- profit-sharing and bonuses; and
- non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees. (IAS 19.5)

Long term employee benefits are recognised as a cost, as entitlement to the benefit is earned, but due to their long-term nature, they are recognised at the expected present value of the liability.

Practical impact and interpretation for preparers

The main difference is that unused paid annual leave might now roll over into a period longer than 12 months. This may create a long-term employee benefit for all or a portion of the holiday pay accrual with accounting and tax consequences.

The cost of these long-term benefits is recognised in the period that the benefit is earned, but due to their long-term nature, this cost should be measured at the expected net present value of the liability.

It is, however, unlikely that the discounting to net present value will be material, and it will also be somewhat challenging to obtain a reliable estimate to when holiday will be used, and so the undiscounted amount is likely to be acceptable in practice.

How might this change impact the entity's year-end close process?

Entities will firstly need to determine if they will permit holiday carry forward.

They then need to determine (as usual) the number of unused holiday days for their employees at end of the accounting period.

They will need to consider the cost value of unused holiday expected to be used within the next 12 months. This will involve making judgements about when employees will use their carried over holiday allowance.

Entities will need to accrue for the net present value of unused holiday expected to be used after 12 months, which will, where material and able to be reliably measured, be subject to an appropriate discount rate. Management judgement will be required to determine an appropriate discount rate, if any.

Where material, additional disclosures will be required including:

- the nature of long-term benefits provided, the liability recognised and if applicable any funding put in place to meet these liabilities;
- the accounting policy applied for short-term and long-term holiday pay accruals; and
- any significant judgements made eg expected timing of use of accrued holiday and determination of an appropriate discount rate.

Our advice

- Entities should already have measures to track unused holiday entitlement and include a consideration of holiday requirement in their year-end close process as this is required by IAS 19.
- The entity's judgement of how and when holiday is taken should be consistent with the entity's policies, including communications with clients. It should also be consistent with staff utilisation assumptions used in trading projections that underpin going concern and any other value in use exercises.

Ultimately the element of non-current pay and impact of discounting may be immaterial depending on the facts and circumstances of the business.

2.5 Defined benefit pension schemes

With the impact of coronavirus on markets, mortality and interest rates, net defined benefit pension scheme liabilities under IAS 19 may increase in the short term mainly due to a fall in the value of any plan assets. They may also be impacted, to a less certain degree, by the effects of changes in the principal actuarial assumptions used to measure the defined benefit obligation.

What does IFRS say?

IAS 19 Employee Benefits addresses the measurement of the net defined benefit liability (asset). The net defined benefit liability (asset), is the deficit (surplus) adjusted for any effect of limiting a net defined benefit asset to the asset ceiling i.e. the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

The deficit or surplus is the:

- Present value of the entity's obligations under defined benefit plans at the reporting date (referred to as 'the defined benefit obligation'); less
- Fair value at the reporting date of plan assets (if any) out of which the obligations are to be settled.

The discount rate used to determine the present value of the defined benefit obligation should be determined by reference to market yields at the reporting date on high-quality corporate bonds of equivalent currency and term of the benefit obligations (IAS 19.83). The reference to high-quality is not defined or explained.

IAS 19.58 requires the net defined benefit liability (asset) to be determined with sufficient regularity that the amounts recognised in the financial statements do not differ materially from the amounts that would be determined at the end of the reporting period.

IAS 19.59 does not require, but encourages, an entity to involve a qualified actuary in the measurement of all material post-employment benefit obligations. The qualified actuary may carry out a detailed valuation of the obligation before the end of the reporting period so long as the results of

that valuation are updated for any material transactions and other material changes in circumstances (including changes in market prices and interest rates) up to the end of the reporting period.

IAS 19.144 requires disclosure of the significant actuarial assumptions used to estimate the defined benefit obligation; typically, these include the discount rate, expected rate of salary increases and any other material actuarial assumptions. IAS 19.145 also requires sensitivity analysis for each significant actuarial assumption.

Practical impact and interpretation for preparers

The measurement of the defined benefit obligation may be impacted by coronavirus due to changes in actuarial assumptions about:

- Mortality rates – these rates are based on mortality projection models. It is still unclear what the ultimate impact of coronavirus will be for such models, and whether any specific short-term adjustments to the latest models available are necessary.
- Employee turnover and salaries – reductions in work force due to mortality in the accounting period or redundancies could result in a significant change in employee numbers. Reductions in salary as a result of furlough are not anticipated to result in significant changes in long term assumptions such as career average salaries.
- Discount rate – any impact of coronavirus on high-quality corporate bond yields at the reporting date should be considered, and the discount rate updated accordingly. It is possible that high-quality corporate bond yields may escape some of the fluctuations seen by lower-quality, high-yield bonds. High-quality corporate bond yields saw a downward trend during 2019 and into February 2020 before recovering; for March 2020 reporting dates yields are anticipated to have recovered to a not dissimilar level to those used in the assumptions for March 2019 reporting dates for shorter term liabilities (eg 10 years) but are expected to be lower for longer term liabilities (eg 15, 20 and 25 years).
- Past service cost – Any changes to the terms or membership of a defined benefit plan as a result of coronavirus might result in a plan amendment or a curtailment or settlement. IAS 19 requires an entity to determine the amount of any past service cost, or gain or loss on settlement, by remeasuring the net defined benefit liability before and after the amendment, using current assumptions and the fair value of plan assets at the time of the amendment. The gain or loss should be recognised in the P&L.

As noted earlier, there is no requirement to obtain a full actuarial valuation annually, nor for it to be performed at the reporting date. Some entities therefore adopt an approach of updating the latest full actuarial valuation for certain other changes if the principal actuarial assumptions (other than the discount rate which is always updated at the reporting date), have not changed significantly. Such an approach is unlikely to be appropriate given the potential impact of coronavirus on the assumptions, even if the full actuarial valuation was relatively recent.

The value of plan assets is likely to have changed significantly due to the adverse effects of coronavirus on the markets and the resulting volatility in those markets. A further and related consequence is that some assets may become harder to value, particularly when markets become inactive or illiquid. It may be relatively easy to obtain valuations for some assets, but where quoted prices are not available, entities will need to ensure that they have obtained an appropriate valuation at their reporting date.

The significant economic uncertainty caused by coronavirus may make updating valuations more challenging where the pension scheme reporting date is non coterminous with the entity's year end or where valuations of investments have been prepared based on information at an earlier date to the entity's reporting date.

Disclosures in respect of the key sources of estimation uncertainty, such as those listed in the bullet points above, may need to be more extensive than in the past in order to provide users of the financial statements with useful information about the judgements management has made in deciding their assumptions and how they may impact the financial statements. This may require disclosures in addition to the nature and amount of significant actuarial assumptions and a sensitivity analysis in respect of those assumptions, including methods and assumptions used to prepare sensitivities (reasons for changes to methods or assumptions and any limitations to those methods) and the effect on the defined benefit obligation, as required by IAS 19.

Movements as a result of the above actuarial assumptions will be reflected in other comprehensive income. There may also be a less material impact on the current service cost reflected in profit or loss as a result of a reduction in employee numbers. It is not anticipated that reductions in salaries as a result of furlough will have a material impact on the current service charge. Changes to the discount rate will affect net interest on the net defined benefit liability (asset) recognised in profit or loss. The actual return on plan assets (excluding net interest) will be reflected in other comprehensive income.

Our advice

- Consider whether the principal actuarial assumptions in the valuation of the defined benefit obligation could have changed significantly as a result of coronavirus, in particular those outlined above. If the assumptions are expected to have changed, clients should engage early with their actuary for advice and to obtain a comprehensive actuarial valuation to recognise in their financial statements. Given current volatility in markets and fast changing conditions, consideration should also be given to obtaining the actuarial valuation as at a date as close as practicable to the reporting date to reduce the need to update the actuarial valuation for changes in the intervening period.
- Consideration should also be given to whether it would be useful to provide, and the extent of, additional disclosures in respect of those key assumptions that have been particularly impacted by the event of coronavirus. In deciding whether additional disclosure is necessary entities should refer to the disclosure objectives in IAS 19.135; to explain the risks and amounts in the financial statements arising from defined benefit plans and how the defined benefit plan may affect the amount, timing and uncertainty of future cash flows. Additional disclosure may also be needed in any strategic report/narrative reporting to explain the impact of coronavirus on the entity's funding of its pension scheme liabilities.
- It is also recommended that clients speak to the pension scheme trustees to understand how the value of plan assets has been impacted by coronavirus. Many schemes will have a degree of hedging in place within their investment strategy, and clients should seek to understand how successful any such hedging has been in relation to wider market movements.
- Whilst not impacting on the measurement of the net defined benefit obligation, coronavirus may have impacted an entity's cash flows. In respect of contributions to defined benefit pension plans it may be appropriate for employers to speak to the pension scheme trustees regarding the deferral of deficit repair contributions.

2.6 Shared-based payments

During this period of economic uncertainty, when cash is limited, companies may seek to incentivise employees using non-cash benefits such as share-based payments. As well as this, existing share-based payment schemes may vest based on conditions such as employment continuity or KPI achievement which may be impacted by the current economic volatility.

Share based payments is a complex area of accountancy and this memo does not cover the basic principles of how they are recognised under IFRS 2. This article considers some areas that may be of greater complexity or judgement during the coronavirus pandemic.

What does IFRS say?

IFRS 2 Share-based Payment covers two types of share-based payments for goods or services received:

- Equity settled share-based payments; or
- Cash settled share-based payments.

The entity should recognise a share-based payment (as either equity and/or a liability) when it receives the goods or services.

Most typically, share-based payments relate to services given to entities by employees. In this case, the standard states that fair value must be measured by reference to the fair value of the equity instruments granted measured at the grant date.

Fair value is based on market prices if available, taking into account the terms and conditions upon which equity instruments were granted. If market prices are not available, fair value is estimated using a valuation technique that is consistent with generally accepted valuation methodologies for pricing financial instruments. IFRS 2, Appendix B contains guidance on the measurement of the fair value of shares and share options.

Practical impact and interpretation for preparers

Measurement and recognition of share-based payments during coronavirus

With the economic impact of coronavirus, if an entity grants new share-based payments, they will need to apply careful consideration for the determination of the fair value of their equity instruments; carefully considering both micro and macro-economic conditions that are changing daily.

If the entity uses market prices, they will need to consider the daily fluctuations in the markets as a result of the pandemic.

If the entity uses a valuation technique, they may find it difficult to obtain data to reliably measure the fair value during such a time of uncertainty. This is because any fair value assumptions used in a model will likely be subject to a high level of variability and complexity. For example, the commonly used Black-Scholes model uses expected share price volatility as an input, and although data will be available, higher volatility will imply a higher valuation which may be surprising to clients.

Recognition of historic share-based payments during reporting dates falling during coronavirus

Entities may also want to consult with an employment law specialist as to whether furloughing an employee would impact vesting periods relating to employee service length. For many share option schemes a key condition is continuing employment. A furlough of an employee might disqualify the employee from the scheme and the impact on the accounts may be that the charge is no longer required in the accounts.

Share-based payment schemes include performance conditions which may have been deemed probable in the past. If a performance condition exists that impacts vesting (such as a growth in EBITDA target) and it becomes not probable this might trigger a reversal of previously recognised expense in relation to the share-based payment.

If entities modify existing share-based payment schemes (eg because they are now out of the money) the accounting may change and it is possible that additional compensation expense might arise as a result of these modifications.

Our advice

Prepare a board paper that clearly documents the entity's approach to share based payments issued during the year. This should include, as a minimum:

- an explanation of the scheme;
- a determination of whether it is an equity settled share-based payment scheme or a cash settled share-based payment scheme;
- a high-level summary of the quantum of the scheme including number of participants and length;
- whether fair value is based on market prices or a valuation technique, with a clear explanation of which valuation technique has been applied and why;
- an explanation of key judgements and estimates applied in determining fair value, with supporting evidence enclosed where appropriate; and
- documentation of what experts have been liaised with.

Don't rely on an taxation authority approved tax value. It is rarely appropriate for accounting purposes as they are prepared on a different valuation basis. In some cases, the work performed for a taxation authority approved tax valuation can be extended and used to derive an accounting valuation.

Review furloughed staff for employees who hold and seek further advice on the validity of their options as this may impact the charge recognised in the accounts and the related disclosures.

Review the basis of accounting for existing share-based payment schemes and consider if any performance conditions exist which are now deemed not probable and the subsequent impact on accounting.

The accounting and tax consequences of any proposed modifications of existing share-based payment arrangements should also be reviewed and considered before making any modifications.

3. NON-CURRENT ASSETS

3.1 Intangible assets

Entities holding significant intangible assets may find that changes in strategy or reductions in forecast revenues due to coronavirus will not only provide evidence of impairment but will also reduce the ability of the entity to meet the recognition criteria of intangible assets. This could mean an increase in costs being expensed to the P&L with knock on consequences for performance related pay, bonuses and covenants.

What does IFRS say?

Initial measurement

The recognition criteria for intangible assets is (IAS 38.21):

- it must be probable that the expected future economic benefits attributable to the asset will flow to the entity; and
- the cost or value of the asset can be measured reliably.

To assess whether an internally generated intangible asset meets the criteria for recognition, an entity classifies the generation of the asset into (IAS 38.52):

- a research phase; and
- a development phase.

Expenditure on research (or on the research phase of an internal project) shall be recognised as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) shall be recognised if, and only if, an entity can demonstrate **all** of the criteria in IAS 38.57.

For intangible assets acquired in a business combination, additional conditions to those above are required to be satisfied ie:

- the intangible asset arises from contractual or other legal rights; or
- the intangible asset is separable (ie capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged either individually or together with a related contract, asset or liability).

An entity should initially measure the asset at cost.

- For internally generated intangible assets, the cost is the sum of the directly attributable expenditure incurred from when the asset first meets the recognition criteria, including any directly attributable borrowing costs. If an intangible asset is acquired through a business combination, then the cost is the fair value at the acquisition date.

An entity must capitalise borrowings costs (IAS 23) only if those costs that are directly attributable to the asset can be capitalised (ie costs that would not have been incurred if the expenditure on the asset had not been made). The entity should:

- capitalise borrowing costs as part of the cost of a qualifying asset from the point when it:
 - first incurs both expenditure on the asset and borrowing costs;
 - and undertakes activities necessary to prepare the asset for its intended use or sale;
- suspend capitalisation during extended periods where active development of the asset has paused; and
- cease capitalisation when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

Subsequent measurement, including impairment

Entities have a choice to subsequently measure the intangible assets recognised using either the cost or revaluation model. (providing that there is an active market for the asset) (IAS 38.72)

An asset held under the cost model is measured at cost less accumulated amortisation and any impairment losses. Impairment losses recognised for goodwill shall not be reversed in a subsequent period.

The [article on impairment of assets](#) explains how and when an entity reviews the carrying amount of its assets (ie assess at each reporting date whether there are any indicators of impairment), how it determines the recoverable amount of an asset, and when it recognises or reverses an impairment loss. (IAS 36)

Holding an intangible asset at valuation is rare given the limited active markets available for many intangible assets, and so commentary in this article is limited to a reminder on booking the increase or decrease:

- Any increases in an asset's value as a result of a revaluation is recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss, otherwise the increase taken to other comprehensive income and accumulated in equity under the heading of revaluation surplus.
- Any decrease in an asset's valuation is firstly taken to other comprehensive income to reverse previously recognised gains in respect of that asset. To the extent that the devaluation exceeds previous revaluation gains, the excess shall be recognised in profit or loss.

Practical impact and interpretation for preparers

- The requirement for future economic benefits to flow to the entity may now mean that many costs do not meet the recognition criteria to be capitalised as intangible assets. The assessment of future cash flows must be made over the useful life of the asset, using reasonable and supportable assumptions and a degree of judgement must be used to assess the certainty attached to the flow of the economic benefits.
- Internally generated development costs which were previously capitalised (such as staff costs for the development of intangible assets) may now not meet the requirement for recognition, meaning that entities will see an increase in the level of development costs expenditure being expensed to the P&L. In addition, if costs relating to a certain project no longer meet the requirement for capitalisation, then this is an indicator of impairment for the costs previously recognised as an intangible asset.
- Costs expensed because they do not meet the requirement for capitalisation may not be recognised at a later date as part of a cost of an intangible asset (IAS 38.71).
- Changes in entity strategy may result in the automatic impairment of some intangible assets. For example, a decision not to progress with a certain product, or revenue stream as a result of coronavirus may result in an impairment of any purchased brands, patents, trademarks or other recognised intangibles relating to these specific plans.
- The impact of coronavirus may mean that there are reductions to the useful lives of intangible assets, especially if it becomes unlikely that an entity will renew its contractual or legal rights. As a result, any accelerated amortisation is required to be taken to the P&L on a prospective basis.

- Where an entity capitalises borrowing costs, any delays to the development of an asset may mean that the capitalisation of borrowing costs may need to be suspended and instead expensed to the P&L.

Our advice

- Entities must consider whether there are any indicators of impairment of their intangible assets.
- Entities should assess their internal processes for capitalising internally generated expenditure to ensure that only costs meeting the recognition criteria are capitalised as intangible assets. Costs for consideration include:
 - Staff costs where staff have been unable to perform work on the intangible asset in question. If these costs are automatically journalised as an intangible asset each month, management may need to make a manual journal to move the costs to the P&L for the period in which there was no development.
 - Management should suspend the capitalisation of directly attributable borrowing costs during a period in which no development of the asset is taking place.
 - Any additional materials or costs (such as legal costs), incurred as a result of delays to development, should be assessed to ensure that they meet the criteria for recognition.
- Entities should review the useful lives of the intangible asset, including the consideration of any renewal periods included in the estimates, to ensure that they remain appropriate in light of the current economic environment.
- For entities with significant R&D an increase in costs being charged to P&L may affect performance related pay, bonuses, share options and covenants, and so these should all be reviewed.

3.2 Property, plant and equipment

The recognition and measurement of existing, or additions to, property, plant and equipment may be significantly affected by changes resulting from coronavirus. This could include changes to strategy, decreases in expected future cash flows or costs incurred as result of delays to the development or manufacture of assets.

What does IFRS say?

Initial measurement

IAS 16 states that the recognition criteria for property, plant and equipment tangible assets is:

- it is probable that future economic benefits associated with the item will flow to the entity; and
- the cost of the item can be measured reliably.

Upon initial recognition, assets must be recognised at cost which includes legal fees, costs associated with bringing the asset to the location and condition necessary to be used by the business, costs associated with dismantling, and any borrowing costs that can be capitalised.

An entity must capitalise borrowing costs (IAS 23) only if those costs that are directly attributable to the asset can be capitalised (ie costs that would not have been incurred if the expenditure on the asset had not been made). The entity should:

- capitalise borrowing costs as part of the cost of a qualifying asset from the point when it:

- first incurs both expenditure on the asset and borrowing costs;
- and undertakes activities necessary to prepare the asset for its intended use or sale;
- suspend capitalisation during extended periods where active development of the asset has paused; and
- cease capitalisation when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

Subsequent measurement

IAS 16.29 explains that entities have a choice to subsequently measure the property, plant and equipment recognised using either the cost or revaluation model.

Under the cost model the asset is measured at cost less accumulated depreciation and impairment losses.

Under the revaluation model as explained further below, the property, plant and equipment should be measured at the [fair value at the date of revaluation less any subsequent depreciation and impairment losses](#).

- Any increases in an assets value as a result of a revaluation is recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss, otherwise the increase is taken to other comprehensive income and accumulated in equity under the heading of revaluation surplus.
- Any decrease in an asset's valuation is firstly taken to other comprehensive income to reverse previously recognised gains in respect of that asset. To the extent that the devaluation exceeds previous revaluation gains, the excess shall be recognised in profit or loss.

Practical impact and interpretation for preparers

- The requirement for future economic benefits to flow to the entity may now mean that some costs do not meet the recognition criteria to be capitalised as property, plant and equipment.
- Where assets have been purchased for a revenue stream or branch of the business that is being discontinued as a result of coronavirus, the entity will need to consider the treatment of the assets recognised for that specific stream or business.
- A decision to sell an asset on to a third party may result in it being classified as 'held for sale' if the conditions in IFRS 5 are met. Assets held for sale are measured at the lower of carrying amount and fair value less costs to sell. For assets that do not meet the criteria to be classified as 'held for sale', the decision to dispose of the asset is an [indicator of impairment](#).
- The impact of coronavirus may mean that there are reductions to the useful lives or residual values of assets. As a result, accelerated depreciation is required to be taken to the P&L.
- Where an entity has a policy of capitalising borrowing costs, any delays to the development of an asset may mean that the capitalisation of borrowing costs may need to be suspended and instead expensed to the P&L.

Our advice

- Entities should review their internal processes for capitalising asset purchases to ensure that only costs meeting the recognition criteria are capitalised as property, plant and equipment, including the capitalisation of borrowing costs. The costs of bringing the asset to the location

and condition necessary to be used by the business may be greater than originally forecast if the impact of coronavirus has caused delays to the asset manufacture process.

- Where entities hold assets under the revaluation model, they should ensure that they have complete records of the historic gains recognised in other comprehensive income so that impairment losses can be correctly used to reduce the revaluation reserve in the first instance.
- Entities should review the useful lives and residual values attributed to any tangible assets to ensure that they remain appropriate in light of the current economic environment.

3.3 Investment property and impairment of property

The knock-on effect of having a lockdown is the significant impact on the real estate sector. Investor spend on real estate has dropped sharply. This is likely to have an impact on the valuation of all business property under IFRS.

What does IFRS say?

Under IFRS property is classified as Investment property (IAS 40) or [Property, Plant and Equipment](#) (IAS 16).

Investment property may be measured using:

- the cost model – at cost less any accumulated depreciation and impairment losses (IAS 40.56); or
- at fair value at each reporting date with changes in fair value recognised in profit or loss (IAS 40.35).

Property classified as Property, Plant and Equipment (PPE) may be measured using:

- the cost model – at cost less any accumulated depreciation and impairment losses (IAS 16.30); or
- the revaluation model – fair value at the date of revaluation less any subsequent depreciation and impairment losses with revaluations made with sufficient regularity to ensure that the carrying amount does not differ materially from fair value at the reporting date (IAS 16.31).

For Investment Property, and PPE measured using the revaluation model, the carrying value of a property at the year-end should be fair value (or an amount not materially different from fair value).

For Investment Property, and PPE measured using the cost model, preparers of the accounts should reflect any impairment of the carrying amount of the property. Where [indicators of impairment exist](#), preparers of accounts are required to assess the recoverable amount of the property which includes a determination of the higher of *fair value less cost to sell* and *value in use* of the property and recognise an impairment when the recoverable amount is lower than the carrying value.

Changes in the carrying value of a property should be considered for [deferred tax implications](#).

Practical impact and interpretation for preparers

For investment property and PPE measured at revaluation, preparers will need to reflect the fair value of a property at the reporting date. In practice this will require a valuation exercise to be performed by the directors, which may involve the engagement of a property valuation expert. IAS 40 encourages, but does not require, valuation by an independent valuer who holds a recognised and relevant professional qualification and has recent experience in the location and category of the investment property being valued.

The valuation expert's report may include a material uncertainty clause in line with the requirements of valuation standards issued by the International Valuation Standards Council (IVSC). This reflects the significant uncertainty that arises where inputs available for a valuation are likely to reflect conditions that existed before the event and that these inputs may not reflect the underlying conditions at the reporting date. Where inputs have been adjusted to incorporate the impact of coronavirus, these may also lead to estimation uncertainty.

In the case of Investment Property, and PPE measured at cost, preparers may need to determine the fair value of a property in assessing whether the carrying value exceeds the recoverable amount.

For entities with a December 2019 reporting date, there is likely to be little impact on the valuation of property at the reporting date because inputs used in the valuation calculation should be based on conditions that existed at 31 December 2019 when the impact of coronavirus on the property market would have been minimal. However, the accounts should include disclosure about the nature and estimated financial effect of the impact of coronavirus on post reporting date fair values.

For entities with a reporting date during or after March 2020, there is likely to be some impact on the value of property at the reporting date as inputs to the valuation calculation will need to take into account the effects on the property market of coronavirus. When determining the inputs to use in the valuation done for March and later reporting dates, the impact of market changes which come to light subsequently may provide evidence of conditions that existed at the end of the reporting period. The valuation should take into account these conditions if they are adjusting events after the end of the reporting period. Due to the rapidly changing situation it may be difficult to determine what factors are indicative of conditions at the year end and what are indicative of factors arising after the reporting date and judgement will therefore be required.

For entities with reporting dates between December 2019 and March 2020, judgement will need to be applied to determine whether there is likely to be a significant impact of coronavirus on the inputs to the valuation.

Our advice

- If a valuation expert has been engaged to assist the directors in determining the fair value of a property, they should contact the experts early to ascertain potential practical issues eg the valuation expert may normally require access to the property as part of their procedures. Some valuations may be able to be performed via a desktop review, but this may not be possible in other cases, for example for new or substantially redeveloped properties.
- Where the basis of valuation is the recent selling price of properties with similar characteristics (use, age, location etc) there may be no recent transactions and entities should consider whether such comparisons with properties sold pre-coronavirus remain appropriate.
- Entities with external funding should review their lending agreements and consider pro-active discussion with lenders as

any reduction of the carrying value of a property will be reflected in the accounts (either as the result of a fall in fair value or an impairment), affecting both interest cover and asset carrying value which in turn may affect covenant compliance.

3.4 Investments in associates, joint ventures and subsidiaries

The economic events surrounding coronavirus will likely have a significant effect on the businesses of associates, joint ventures and subsidiaries. There is an increased likelihood of impairment and of significant changes in fair value and care will be needed to ensure this is reflected correctly from the perspective of the investor's accounting.

What does IFRS say?

Measurement basis

Investments in associates and joint ventures are measured at cost, fair value, or by applying the equity method of accounting, depending on accounting policy choices and whether individual or consolidated accounts are being prepared. Investments in subsidiaries are measured at cost, fair value or by applying the equity method of accounting in individual investor's accounts as an accounting policy choice.

For associates, joint ventures and subsidiaries, measurement of fair value might be carried out using a valuation technique based on unobservable inputs. This will be challenging in the current environment when markets are volatile, and the economic outlook is uncertain.

An investor, shall, in its separate financial statements, account for all of its investments in associates (and all of its joint ventures) using IAS 27.10:

1. the cost model;
2. in accordance with IFRS 9 (i.e. fair value through other comprehensive income, or fair value through profit or loss); or
3. using the equity method as described in IAS 28.

In consolidated financial statements, investments in associates and joint ventures are normally accounted for using the equity method, unless the entity meets specific exemption criteria or has elected to measure its investments at fair value through profit and loss in accordance with IFRS 9 or the investment is classified as 'held for sale' in accordance with IFRS 5 and measured at the lower of its carrying amount and fair value less costs to sell.

In the individual accounts of a parent entity the same accounting policy choice of cost, fair value or equity method applies for each category of investments in associates, in joint ventures and in subsidiaries.

Impairment

Under the equity accounting method in consolidated accounts, on acquisition of an investment in an associate or joint venture, any difference (whether positive or negative) between the cost of acquisition and the investor's share of the fair values of the net identifiable assets of the associate results in notional fair value adjustments to the carrying amount of the investment. (IAS 28.32)

Post-acquisition, the share of profit or losses of the associate or joint ventures is adjusted to account for the additional depreciation or amortisation of any fair value adjustments to tangible assets and intangible assets (excluding goodwill). Components of the investment in the associate or joint venture, such as goodwill and intangibles, are not tested separately for impairment. Instead, the impairment test for an investment in an associate or joint venture is conducted by calculating the recoverable amount of the investment as a single asset. (IAS 28.42)

When the associate or joint venture has recorded an impairment in its own books, the investor accounts for its share of this loss as part of its normal equity accounting. This does not negate the requirement to conduct an impairment review of investments in associates or jointly controlled assets as a single asset. (IAS 28.42)

Equity accounting in consolidated accounts

In applying the equity accounting method, investors are required to use the financial statements of the associate or joint venture as of the same date as the financial statements of the investor unless it is impracticable to do so. If it is impracticable, the investor uses the most recent available financial statements of the associate or joint venture (provided the difference between the end of the reporting period of the associate or joint venture and that of the investor is no more than three months), with adjustments made for the effects of any significant transactions or events occurring between the accounting period ends. (IAS 28.33,34)

In applying the equity accounting method, if the associate or joint venture uses accounting policies that differ from those of the investor, the investor adjusts the associate's joint venture's financial statements to reflect its own accounting policies for the purpose of applying the equity method unless it is impracticable to do so. (IAS 28.35)

In applying the equity accounting method, if an investors' share of losses of an associate or joint venture equals or exceeds the carrying amount of its investment in the associate or joint venture, the investor discontinues its share of further losses. After the investor's interest is reduced to zero, the investor recognises additional losses by a provision only to the extent that the investor has incurred legal or constructive obligations or has made payments on behalf of the associate or joint venture. If the associate or joint venture subsequently reports profits, the investor resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised. (IAS 28.38 & 28.39)

Fair value

Investors can measure investments in associates, joint ventures and subsidiaries at fair value in their individual accounts as an accounting policy choice. Additionally, If an investor elects to measure its investments in associates or joint ventures at fair value through profit or loss in its consolidated financial statements, or is an investment entity that is required to measure its investment in a subsidiary at fair value through profit or loss in its consolidated financial statements, it shall also account for its investment in associates, joint ventures and subsidiaries in the same way in its separate financial statements (IAS 27.11 & 27.11A).

Fair value is measured using assumptions that market participants would use, reflecting market conditions at the measurement date. Use of hindsight or adjusting for what may be viewed as depressed pricing at the measurement date, in light of subsequent changes in market prices, is not permitted.

The best evidence of fair value is a quoted price for an identical asset in an active market, but it is unlikely that such evidence will be available for investments in associates, joint ventures or subsidiaries. When quoted prices for an identical asset in an active market are not available, a valuation technique is used.

Where possible, a valuation technique that uses observable inputs is applied such as:

- a) quoted prices for similar assets in active markets;
- b) quoted prices for identical or similar assets or liabilities in markets that are not active;
- c) valuation techniques where the significant inputs are observable, ie inputs developed using market data such as interest rates.

A valuation technique that uses observable inputs is applied is used to measure fair value in the absence of a quoted price for an identical asset in an active market or in a valuation technique that uses observable inputs.

Practical impact and interpretation for preparers

- The outbreak of coronavirus increases the likelihood of impairment reviews and the recognition of impairment losses being required, as set out in the [impairment review article](#).
- If financial statements of the associate or joint venture are prepared to an earlier date than the consolidated accounts of the investor, care will be needed to ensure coronavirus's effect on the assets and liabilities of the associate or joint venture is understood for the purpose of applying the equity accounting method in the consolidated accounts of the investor.
- Any significant accounting effects under IFRS, brought about by coronavirus, will need to be understood and applied to the financial statements of associates and joint ventures for the purpose of applying the equity accounting method in the consolidated accounts of the investor.
- There is an increased likelihood that associates, and joint ventures will make losses as a result of coronavirus. Care should be exercised in correctly reflecting these losses for the purpose of applying the equity method of accounting in the consolidated accounts of the investor.
- For any fair value measurement using evidence based on a transaction before the occurrence of coronavirus, the basis of using the price will need to be reviewed carefully.
- For reporting periods ending after the outbreak and spread of coronavirus, inputs into valuation techniques should be reviewed carefully to ensure they reflect the economic conditions at the reporting date.
- For material investments, consideration should be given to the level of detail and emphasis on disclosures about valuation techniques, assumptions and estimates used in the measurement of the fair value of investments and sensitivity of fair value measurement to changes in inputs, unless measurement is based on a quoted price for an identical asset in an active market.
- Fair value is measured using assumptions that market participants would use, reflecting market conditions at the measurement date. Use of hindsight or adjusting for what may be viewed as depressed pricing at the measurement date, in light of subsequent changes in market prices, is not permitted.
- Careful consideration will be required of [events after the reporting date](#) related to the outbreak and spread of coronavirus to determine the impact on fair value measurement. It is likely that there will be a decline in the fair value of investments, but the measurement of fair value should be based on conditions existing at the reporting date.

Our advice

- Entities should consider if there are any indicators that their investments in associates, joint ventures and subsidiaries are impaired and ensure they have the necessary information, including the information they need from their investees, to carry out impairment testing if it is required.
- Entities should consider what information they need to accurately account for their interests in associates and joint ventures using the equity accounting method in their consolidated or separate accounts. Additional care will be needed to ensure investors' share of the net assets and profits or losses of their associates and joint ventures are based on accurate underlying information, which reflects the accounting impact of coronavirus on their investees.
- When measuring fair value of their investments in associates, joint ventures and subsidiaries, investors should ensure that valuations reflect market participants' assumptions based on information available and conditions at the measurement date. Valuations should incorporate the risk premiums that will arise from the increased uncertainty and other impacts of coronavirus.

- Entities should consider whether disclosures of key assumptions and estimates should be expanded to include anything relevant to their accounting for investments in associates, joint ventures and subsidiaries, including fair value measurement.

3.5 Business combinations

If entities have grown through acquisition during the year or completed acquisitions during the coronavirus pandemic they must follow the IFRS requirements for business combinations.

What does IFRS say?

IFRS 3 'Business combinations and goodwill' outlines the use of the "acquisition method" of accounting for a business combination whereby the acquiring entity should:

1. identify the acquirer;
2. determine the acquisition date;
3. recognise and measure the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree; and
4. recognise and measure goodwill (or a gain from a bargain purchase) being the excess of (a) over (b):
 - a) the aggregate of:
 - i. consideration transferred;
 - ii. the amount of any non-controlling interest; and
 - iii. the acquisition-date fair value of any previously held equity interest in the acquiree.
 - b) the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed.
5. Acquisition-related costs as expensed as incurred.

IFRS 3.41 also gives specific advice on a business combination that has been achieved in stages. In these situations, an acquirer will obtain control of an acquiree in which it held an equity interest immediately before the acquisition date. When a business combination is achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate.

Practical impact and interpretation for preparers

Considering the stages set out above:

1. The identity of the acquirer is unlikely to be impacted by coronavirus.
2. The acquisition date may have been impacted in the final stages of the deal.
 - a. The acquisition date is defined as the date at which the acquirer obtains control of the acquirer.
 - b. Preparers of accounts should review the terms of each deal and the dates of key events and determine the point at which control is obtained.
 - c. In some cases, the early stages of completion may have occurred before the balance sheet date, but control is not transferred until after the end of the reporting period.
3. With some exceptions, the identifiable assets acquired and liabilities assumed, are recognised and measured at fair value at the acquisition date. This includes intangible assets acquired. For each business combination, the acquirer shall measure non-controlling interests at fair value or its proportionate share of the acquiree's identifiable net assets.

- a. IFRS 3 requires the recognition and measurement of identifiable assets acquired, liabilities assumed and non-controlling interests to be retrospectively adjusted if new information comes to light within one year of the acquisition date about facts and circumstances that existed as of the acquisition date. In practice this means that careful consideration should be given to determining whether information obtained after the acquisition date should result in an adjustment to amounts recognised at the acquisition date and consequential effects on the income statement e.g. depreciation or amortisation.
 - b. For example, a 31 March 2020 reporter might enact a business combination including a book of trade receivables acquired on 1 February 2020. By 30 April it might be apparent that this book of trade receivables includes several items that were impaired or irrecoverable at 1 February 2020.
 - c. The facts and circumstances around the recoverability need to be considered when assessing the fair value at acquisition date.
 - d. The acquirer shall recognise contingent liabilities acquired in a business combination if they are a present obligation and can be reliably measured. The subsequent measurement of the contingent liability is prescribed by IFRS 3.56 to be recognised at the higher of its fair value, and the amount initially recognised less any income recognised under IFRS 15.
4. The consideration transferred is defined as the acquisition-date fair values of assets transferred, liabilities assumed, and equity instruments issued by the acquirer.
 - a. Cash assets are relatively straightforward to determine fair value for, but other assets, liabilities and equity instruments may be subject to more complex fair value assumptions depending on the timing of the deal in the context of the pandemic.
 - b. The fair value of the amounts required to settle contingent consideration may have changed substantially between the date of acquisition to the reporting date.
 - c. IFRS 3 requires the consideration transferred to be retrospectively adjusted if new information comes to light within one year of the acquisition date about facts and circumstances that existed as of the acquisition date. In practice this means that careful consideration should be given to determining whether information obtained after the acquisition date should result in an adjustment to amounts recognised at the acquisition date.
 5. Acquisition-related costs are costs the acquirer incurs to effect a business combination including: finder's fees; advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities. The acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities shall be recognised in accordance with IAS 32 and IFRS 9.

Our advice

Entities should review business combinations enacted in their reporting period carefully including:

- determination of the date of acquisition;
- careful consideration of the fair value of any non-cash items exchanged on business combination;

- identification of all direct costs related to the business combination, especially if there has been a delay. This should include a review of professional fees of advisors at a detailed level to identify which fees relate to the deals and which relate to other matters;
- a detailed review of all assets acquired, and liabilities assumed including careful consideration of the fair value of these items at acquisition date;
- a careful review of deferred and contingent consideration, which may have changed from the acquisition date to the reporting date; and
- Whether the acquired entity is still a going concern at the reporting date.

Entities should also consider business combination enacted in previous reporting periods using the list above, particularly around earn-out and contingent consideration liabilities, and the potential impact on goodwill.

Coronavirus almost certainly constitutes an indicator of impairment. It is advisable to perform an impairment review of intangible assets to consider if these assets require impairment. The Goodwill balance at acquisition must be tested for impairment before the end of the annual period in which the business combination took place and may be impaired as a result of the effects of coronavirus.

3.6 Non-current assets held for sale and discontinued operations

Due to the economic conditions as a result of Covid-19, an entity may be considering or implementing restructuring plans, including the disposal of fixed asset, the disposal or closure of significant parts of its business, or temporarily or permanently ceasing certain business operations.

What does IFRS 5 say?

If a non-current asset's carrying amount will be recovered principally through a sale transaction rather than through continuing use, the non-current asset (or disposal group) must be classified as held for sale. The asset (or disposal group) must be:

- available for immediate sale in its present condition subject only to terms that are usual for sales of such assets (or disposal groups), and
- its sale must be highly probable.

A disposal group is a group of assets to be disposed of, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction.

A discontinued operation is a component of an entity that either has been disposed of or is classified as held for sale and:

- (a) represents a separate major line of business or geographical area of operations,
- (b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations, or
- (c) is a subsidiary acquired exclusively with a view to resale.

An entity should present and disclose information that enables users of the financial statements to evaluate the financial effects of discontinued operations and disposals of non-current assets (or disposal groups).

Measurement

A non-current asset (or disposal group) classified as held for sale (or held for distribution) is measured at the lower of its carrying amount and fair value less costs to sell (or fair value less costs to distribute, respectively). Depreciation on such assets ceases at this point.

Disclosure

These assets should be presented separately in the statement of financial position and the results of discontinued operations should be presented separately in the statement of comprehensive income.

If the above criteria are met *after* the reporting period, an entity shall not classify a non-current asset (or disposal group) as held for sale in those financial statements when issued. However, when those criteria are met *after* the reporting period but *before* the authorisation of the financial statements for issue, IFRS 5.12 says the entity shall disclose the following information in the notes:

- (a) a description of the non-current asset (or disposal group);
- (b) a description of the facts and circumstances of the sale, or leading to the expected disposal, and the expected manner and timing of that disposal;
- (c) if applicable, the reportable segment in which the non-current asset (or disposal group) is presented in accordance with IFRS 8 Operating Segments.

Abandoned assets and disposal groups

For a non-current asset (or disposal group) that is being abandoned by a business, this is not classified as held for sale because its carrying amount will be recovered principally through continuing use.

Non-current assets (or disposal groups) being abandoned include non-current assets (or disposal groups) that are to be used to the end of their economic life and non-current assets (or disposal groups) that are to be closed rather than sold.

An entity shall not account for a non-current asset that has been temporarily taken out of use as if it had been abandoned.

Changes to plans

If an entity has classified an asset (or disposal group) as held for sale or as held for distribution to owners, but the criteria are no longer met, the asset (or disposal group) stops being classified as held for sale or held for distribution to owners (respectively).

The non-current asset (or disposal group) that ceases to be classified as held for sale or held for distribution to owners (or ceases to be included in a disposal group classified as held for sale or as held for distribution to owners) is measured at the lower of:

- (a) its carrying amount before the asset (or disposal group) was classified as held for sale or as held for distribution to owners, adjusted for any depreciation, amortisation or revaluations that would have been recognised had the asset (or disposal group) not been classified as held for sale or as held for distribution to owners, and
- (b) its recoverable amount at the date of the subsequent decision not to sell or distribute.

Practical impact and interpretation for preparers

For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset (or disposal group), and an active programme to locate a buyer and complete the plan must have been initiated. Further, the asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value and be available for immediate sale. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification, and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. The probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the sale is highly probable.

If the entity plans to provide for any restructuring costs, they must have raised a valid expectation in those affected that it will carry out the plan by starting to implement that plan or announcing its main features to those affected by it. If, and only if, both of these criteria are met a restructuring provision should be recognised;

Our advice / Suggested tangible actions clients can take

- If the directors plan to dispose of an asset or line of business and wish to present it as such at year end, we advise that they start the sales process as early as possible.
- As noted above, the asset of disposal group must be ready for immediate sale, therefore if any pre-work is required (ie, restructuring of the business) before a sale can be completed, we suggest that this is addressed as early as possible.

3.7 Impairment of non-financial assets

Entities will need to make assessments on the recoverability of their assets in light of the issues caused by the coronavirus pandemic. Where there are indicators of impairment, an impairment review will be required.

What does IFRS say?

Indicators of impairment

An entity shall assess at each reporting date whether there is any indication that its assets are impaired. If an indication exists, the entity must estimate the recoverable amount of the asset, or, if the asset does not generate cash flows itself, the cash generating unit (CGU) to which the asset belongs. (IAS 36.9). In addition, an annual impairment review is also required for intangible assets with an indefinite life or not yet available for use, and goodwill.

Management should be aware of any indicators of impairment that may develop up to the date of authorising the financial statements for issue and consider whether they indicate an impairment existed at the end of the reporting period.

- One of the primary indicators (IAS 36.12(b)) is where significant changes have had an adverse effect on the economic environment in which the entity operates or in which an asset is located.
- Another key indication is where significant changes have had or are expected to have an adverse effect on the entity and how an asset is used or is expected to be used.
 - These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, plans to dispose of an asset before the

previously expected date, and reassessing the useful life of an asset as finite rather than indefinite.

Measuring the recoverable amount

An asset or CGU is impaired if the recoverable amount is less than the carrying amount of the asset or CGU. The impairment charge is that which is required to reduce the carrying amount to the recoverable amount. The recoverable amount is the greater of the asset's (or CGU's) fair value less costs to sell and the value in use.

- The fair value less costs to sell can be best identified as the sale price that could be obtained in an arm's length transaction in an active market, between willing participants, less the costs of disposal. It is based on the best information that an entity could be expected to obtain. When determining the fair value less costs to sell, entities should consider any restrictions imposed on the asset. Costs to sell should include any costs incurred to obtain permission to relax restrictions.
- The value in use is the present value of the future cash flows expected to be derived from an asset or CGU, and involves an entity estimating the future cash flows to be generated from the asset or CGU and applying an appropriate discount rate. Estimates of future cash flows shall include (IAS 36.39):
 - projections of cash inflows from the continuing use of the asset;
 - projections of cash outflows that are necessarily incurred to generate the cash inflows from continuing use of the asset (including cash outflows to prepare the asset for use) and can be directly attributed, or allocated on a reasonable and consistent basis, to the asset; and
 - net cash flows, if any, expected to be received (or paid) for the disposal of the asset at the end of its useful life.

Applying an impairment loss to a CGU

For assets within a CGU, any identified impairment shall be allocated to the assets firstly to reduce the amount of any goodwill allocated to the CGU, and then to be allocated to the other assets within the CGU pro rata, on the basis of the carrying amount. The carrying amount of any assets within the CGU should not be reduced below its individual recoverable amount.

If goodwill cannot be allocated to a specific CGU, then an entity shall test the impairment of goodwill by determining the recoverable amount of the entire entity (if the goodwill has been integrated) or group of entities (if the goodwill has not been integrated).

Reversals of an impairment loss

An entity shall assess at the end of each reporting period whether there is any indication that an impairment loss recognised in prior periods for an asset other than goodwill may no longer exist or may have decreased. If any such indication exists, the entity shall estimate the recoverable amount of that asset (IAS 36.110). An impairment loss recognised for goodwill shall not be reversed in a subsequent period (IAS 36.124).

Indications that an impairment loss may no longer exist are:

- observable indications that the asset's value has increased significantly during the period;
- significant changes in the technological, economic or legal environment, which have a favourable effect on the entity have taken place during the period;
- evidence is available from the internal reporting that the economic performance of the assets is, or will be, better than expected.

A reversal of an impairment loss for an asset other than goodwill shall be recognised immediately in profit or loss, unless the asset is carried at revalued amount in accordance with another IFRS (for example, the revaluation model in IAS 16). Any reversal of an impairment loss of a revalued asset shall be treated as a revaluation increase in accordance with that other IFRS.

A reversal of an impairment loss on a revalued asset is recognised in other comprehensive income and increases the revaluation surplus for that asset. However, to the extent that an impairment loss on the same revalued asset was previously recognised in profit or loss, a reversal of that impairment loss is also recognised in profit or loss.

Practical impact and interpretation for preparers

- Where, due to coronavirus, an assessment of impairment has resulted in the recognition of an impairment loss, the loss should be recognised immediately in the P&L, unless the asset is carried at a revalued amount in which case the loss should firstly be used to reduce any previously recognised valuation gains, and taken through other comprehensive income.
- Where an impairment charge has been calculated, the financial statements should disclose the amount of impairment for each class of asset or CGU, and a description of the events and circumstances that led to the recognition of an impairment charge.
- Any significant judgements or estimates used in the calculation of the recoverable amount should be disclosed in the accounting estimates and areas of judgement note.

Our advice

- Management will need to consider whether there are any indicators of impairment from coronavirus for the entity's individual assets or CGUs. This consideration should be maintained from the entity's reporting date, to the date of authorisation of the financial statements.
- Where indicators of impairment are present, management must prepare assessments of recoverable amounts. When determining the fair value less costs to sell, this may involve engaging third party valuers to undertake valuations reflecting the price the entity could obtain from the disposal of the asset in an arm's length transaction.
- One of the more complex challenges will be for entities to perform a robust review of expected future cash flows for an asset or CGU given the uncertainty of the current economic and market environment. Significant assumptions, such as forecast sales volumes, prices, gross margins, changes in working capital, foreign exchange rates and discount rates will need to be reassessed and updated as appropriate.
- When preparing the expected future cash flows, management should also consider if coronavirus will result in additional cash outflows to ensure the continuing use of the asset (such as additional marketing costs).
- Management should also ensure they have considered the impact of adopting IFRS 16 and whether the RoU asset has been reflected in the CGU assets.
- Management should also consider whether the discount rate used in any recent valuations has been updated to reflect the impact of coronavirus on the risk environment at the reporting date.

4. CURRENT ASSETS AND LIABILITIES

4.1 Inventories

Coronavirus is certainly going to disrupt manufacturing and supply for many businesses. This, in turn, will have an effect on the valuation of inventories under IFRS.

What does IFRS say?

IAS 2 states that inventories must be held at the lower of cost and net realisable value.

The cost of inventories includes the cost of purchase, conversion, and any other costs incurred to bring the inventory to its present location and condition. IAS 2 states that fixed production overheads are allocated to the costs of conversion on the basis of the normal capacity of the production facilities, and variable costs are allocated to each unit on the basis of actual production usage. The standard also specifies that abnormal amounts of wasted materials and labour, storage costs and selling costs are not included as part of the cost of inventories.

Borrowing costs that are directly attributable to bringing the inventory to its present location and condition must also be included in the cost of inventories (IAS 23) (unless the inventories in question are manufactured, or otherwise produced, in large quantities on a repetitive basis in which case IAS 23 does not apply to inventories).

Practical impact and interpretation for preparers

- Entities may have inventories rendered obsolete due to coronavirus, for example if the business has had to close or reduce operations, particularly if inventory is perishable, or if the inventory is stored in a location which is not accessible due to the pandemic. Obsolete inventory is required to be written down to its net realisable value, which could currently be significantly lower than cost.
- Inventories should be measured at the lower of cost and net realisable value. If selling prices fall and/or cost to complete and sell increase, inventory may need to be written down.
- Entities that export their products overseas and sell in foreign currencies may be particularly impacted. Exchange rate volatility may result in a reduction in selling prices if businesses do not pass on the cost of this onto customers, meaning that net realisable value is lower than cost.
- Employee absence due to illness or isolation and the implementation of social distancing measures in the manufacturing sector may mean that production capacity is significantly reduced. The standard requires that the allocation of fixed production overheads is based on normal capacity, and so reduced production capacity may limit this. Any abnormal costs should be expensed as incurred. If a standard costing system is not used, an exercise will need to be undertaken to identify these abnormal costs.

Our advice

- Entities with reporting dates before the coronavirus outbreak will need to consider the interaction between accounting for inventory with the requirements of IAS 10 [Post Balance Sheet Events](#).
- Entities should assess whether any of their inventory is likely to be obsolete or sold for a reduced price as a result of the pandemic and impair inventory down to net realisable value where required.
- Expected production capacity over the period of the pandemic should be estimated and compared to normal production capacity. If an entity expects this to reduce significantly, excess overheads which are normally allocated as costs of conversion should be expensed to the profit or loss account in the period in which they are incurred.

- Entities should ensure they track any wasted materials and labour, storage costs and selling costs as a result of coronavirus and expense these to the income statement, rather than including as part of the cost of inventory.

4.2 Foreign currency transactions

The foreign exchange volatility caused by coronavirus could significantly affect entities' profit or loss and the way foreign currency transactions are translated.

What does IFRS say?

IAS 21 prescribes that all foreign currency transactions should be recorded in the functional currency by applying the spot rate between the functional currency and the foreign currency at the date of transaction or a rate that approximates to the spot rate.

Subsequently, the treatment of foreign currency items depends on whether the item is:

- monetary or non-monetary (monetary items are defined as units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency); and
- carried at historical cost or fair value.

Foreign currency monetary items are translated using the closing rate. Non-monetary items are translated using the exchange rate at date of transaction (or if at fair value, date at which fair value was measured).

Exchange gains and losses are recognised in profit or loss (IAS 21.28). However, there are exceptions to the rule:

- if a monetary item is designated as a hedging instrument in a cash flow hedge, any exchange difference that forms part of the gain or loss on the hedging instrument is recognised in other comprehensive income;
- if a monetary item is designated as a hedge of a net investment in the consolidated financial statements, any exchange difference on the hedging instrument that is considered to be an effective hedge is recognised in other comprehensive income; and
- if a monetary item forms part of the net investment in a foreign operation in the consolidated financial statements then such exchange differences must be recognised in other comprehensive income and accumulated in equity.

Practical impact and interpretation for preparers

Many entities use the average exchange rate method for translating foreign currency transactions at initial recognition on the assumption that the average rate approximates to the spot rate. Entities generally consider the fluctuations in the exchange rates and the volume and size of the transactions when determining whether using average exchange rates is appropriate. Significant changes in the foreign currency exchange rates which may occur during these uncertain times might mean that the use of an average rate is inappropriate and the period over which the average rates are calculated may need to be shorter.

As a result of the fluctuations in exchange rates, many entities may develop hedging strategies to mitigate the profit or loss impact. A number of entities may look to prospectively [apply hedge accounting](#) to mitigate the profit or loss volatility resulted by significant exchange rate movements.

There may also be some large gains and losses arising on foreign currency transactions and entities should consider how these are disclosed in the financial statements. It may be necessary to disclose

material gains and losses separately either on the face of the primary statements or in the notes to the accounts.

Our advice

- Reconsider the period over which the average exchange rates are calculated.
- Consider updating accounting systems and processes to apply appropriate exchange rates.
- Consider the implications of applying hedge accounting prospectively.
- Consider how gains and losses are disclosed in the financial statements.

4.3 Accounting for tax

Entities will need to consider a number of matters in relation to the recognition and measurement of current and deferred tax as a result of coronavirus.

A tax expert should be consulted for advice on the tax implications in the context of the specific circumstances.

What does IFRS say?

IAS 12 states that current tax should be measured at the amount of tax an entity expects to pay or recover, based on taxable profits for current and past periods, calculated using the tax rates and laws that have been enacted or substantively enacted by the reporting date. Entities are also required to recognise a current tax asset for the benefit of a tax loss that can be carried back to recover tax paid in a previous period.

Under IAS 12 deferred tax liabilities are recognised in respect of all taxable temporary differences at the reporting date. Unrelieved tax losses and other deferred tax assets are recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised. Deferred tax assets and liabilities need not be recognised where they fall within the initial recognition exemptions in IAS 12.

Specific recognition rules apply to deferred tax arising from investments in subsidiaries, branches and associates, and interests in joint ventures.

Deferred tax assets and liabilities are measured at the tax rates expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax assets and liabilities shall reflect the manner in which the entity expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Practical impact and interpretation for preparers

Current Tax

Governments across the world have been making a number of reliefs available to businesses to reduce the impact of the pandemic on the economy. The key factor in understanding the financial reporting implication of the relief is determining whether the relief is:

- a tax relief, accounted for in accordance with IAS 12;
- a government grant, accounted for in accordance with IAS 20;
- or an item that is within the scope of another section of IFRS.

Other current tax impacts

Area	Overview	Tax implications
Transfer pricing	Changes in commodity price, reacting to availability in the market, may impact the relevance of previously prepared benchmarking studies used to support transfer pricing policies.	Transfer pricing may have to be revisited, impacting the entity's tax charge.
Insurance claims (eg business interruption)	Many businesses lack the appropriate cover in their policies.	<p>Compensation for loss of profits will be recognised in profit or loss and is likely to constitute taxable income in many cases.</p> <p>In accordance with IAS 37, the income should be recognised when it is virtually certain that the cash will be received from the insurer, and the amount can be measured reliably. This will usually be when the insurer has accepted liability but may be later when the amount received is subject to assessment or negotiation.</p>
Research and development credits	<p>One department that may be a candidate for furloughing is the research and development department.</p> <p>As these employees will not be working on research and development during the period they are furloughed, this may restrict the value of any R&D credits that can be claimed.</p>	There may be uncertainty as to whether R&D credits can be claimed and therefore whether the tax relief should be recognised before any claim is agreed.
Dividends received from subsidiaries	Entities may decide to distribute profits from subsidiaries to meet cash flow requirements or to maintain dividend policies.	<p>Depending on the jurisdiction of the subsidiary, it may be that the dividend is taxable on the parent, creating a current tax liability when received.</p> <p>Even when dividend income is not taxable in the hands of the parent, there may be withholding tax payable on profits distributed from subsidiaries in certain jurisdictions. This could give rise to a deferred tax liability where there is a delay between the dividend being declared (pre year-end) and being paid (post year-end).</p>
Tax residency	Travel restrictions in place globally may make it impossible for company directors to travel to the place of tax residency for Board meetings.	<p>Whilst having to hold one Board meeting in another country due to the travel ban is unlikely to change tax status, this should be monitored, particularly if the travel ban continues for a prolonged time. This would be particularly relevant for businesses whose tax residency status is already contentious.</p> <p>Where businesses are deemed resident in a jurisdiction, they may be liable to additional current tax, dependant on tax treaties in place.</p>

Deferred Tax

Deferred tax assets should only be recognised to the extent that they are recoverable. coronavirus has impacted the profitability of many businesses in many sectors, through inability to trade or commodity price increases. This could lead to businesses generating losses for the financial year, or an increase in losses where businesses were already loss making.

Businesses should consider tax planning opportunities such as:

- loss relief available in group scenarios; or
- disclaiming capital allowances or other allowances available.

Where losses cannot be used, a potential deferred tax asset is created, which must be considered for recoverability.

IAS 12.35 states that the very existence of unrelieved tax losses is strong evidence that there may not be other future taxable profits against which the losses can be relieved. Careful consideration should be given to whether there is sufficient supporting evidence that any unrelieved tax losses, or other deferred tax assets, will be recoverable in the future.

The recognition of deferred tax assets are usually supported by profit forecasts produced by management, demonstrating that it is expected that sufficient taxable profits will be generated in the future to relieve the losses, These forecasts should be reassessed and updated for changes expected during the pandemic, and as the business recovers. The revised forecasts should reflect the expectations at the reporting date and demonstrate the recoverability of not only new deferred tax assets created due to losses generated during the pandemic, but also any historic deferred tax assets previously recognised. The assumptions made should be consistent with other assessments including the impairment of non-financial assets and going concern.

Remember there are often special tax rules for carried forward losses and so you should consult with a tax expert to ensure deferred tax assets for such losses will be recoverable.

Where deferred tax assets are not considered recoverable, they should not be recognised on the balance sheet. Where previously recognised deferred tax assets are no longer considered to be fully recoverable, they should also be derecognised to the extent that they are no longer recoverable. The impact of the deferred tax charge should be recognised in the Statement of Comprehensive Income, or the Statement of Other Comprehensive Income.

This assessment of deferred tax assets is not limited to deferred tax assets recognised in respect of carried forward losses but should be considered for all deferred tax assets eg those recognised on a defined benefit pension scheme liability.

Other deferred tax implications

Relief	Overview	Tax implications
Impact of changes in the carrying value of other assets and liabilities	<p>It is likely the coronavirus will impact the carrying value of:</p> <ul style="list-style-type: none"> • assets (eg investment property, property plant and equipment, right-of-use assets for leases or intangibles) • liabilities (eg provisions and defined benefit pension scheme liability) 	Where impairments of assets are processed, or the value of assets or liabilities are altered, the relevant deferred tax impact of the movements should be considered.
Subsidiaries in other jurisdictions	<p>Governments around the world have implemented reliefs for struggling businesses.</p> <p>Subsidiaries may have taken advantage of such reliefs which will need to be appropriately reported in the consolidated financial statements.</p>	<p>Any government reliefs which have been taken by subsidiaries should be scrutinised and expert advice taken, to assess whether there are current or deferred tax implications for the consolidated financial statements.</p> <p>If funds are remitted from overseas subsidiaries in the form of dividends that are subject to withholding tax, there may be deferred tax implications.</p>

For entities with reporting dates ending before or in December 2019, the effects of coronavirus will likely be a [non-adjusting post balance sheet event](#). The assessment of the recoverability of deferred tax assets should only include the impact on future profitability that existed at the reporting date. However, disclosure may be required to provide readers with information about the impact of coronavirus on the carrying value of the deferred tax asset recognised at the reporting date where there has been a significant effect since that date.

Disclosures in the financial statements

In order to show a true and fair view, for the reader of the financial statements to understand movements in the financial statements, and to distinguish the impacts of coronavirus from other changes, it may be necessary to disclose the following:

- an explanation of changes in the applicable tax rate compared to the prior period;
- the amount and expiry date (if any) of any carry forward tax losses;
- the nature of evidence supporting the recognition of deferred tax assets when the entity has suffered a loss in the current period; and
- the impact of events and circumstances arising after the reporting date on the assets and liabilities recognised in the balance sheet at the reporting date.

Our advice

Entities should consider the following:

- revising assessments for the recoverability of any deferred tax assets, updating for up to date estimates of the impact of the pandemic, both during the lockdown and the recovery periods;
- reassessing tax planning opportunities in light of the changes of circumstance, and obtain expert tax advice where necessary;
- regularly reviewing latest government announcements to take advantage of available reliefs;
- considering the substance of reliefs utilised carefully, to distinguish between government grants (accounted for in accordance with IAS 20) and tax reliefs; and
- ensuring adequate disclosures are made in the financial statements to provide a reader with a sufficient understanding of the changes in the tax position.

4.4 Leasing arrangements

Coronavirus could impact both lessors and lessees as businesses or individuals may not have the liquid cash to pay their rent when it falls due which could impact accounting for leases.

What does IFRS 16 Leases say?

Impairment of right-of-use assets – transitioned lease agreements

Lease agreements that result in the recognition of a right of use asset applying the cost model are required to apply IAS 36 'Impairment of Assets' to determine whether the right-of-use asset has been impaired and to account for any impairment loss. It is important to identify that right-of-use assets are explicitly included in the requirements relating to [impairment](#).

Lessees who apply fair value accounting to some or all of their right-of-use assets should continue to apply their usual fair value models.

Onerous lease agreements – short-term lease agreements and low value assets

Where an entity has elected not to measure a right-of-use asset and liability in respect of short-term or low value lease agreements (IFRS 16.5) or still retains some element of a lease agreement existing at the date of transition to IFRS 16 (accounted for as a short-term lease in IFRS 16.C10(c)), the lessee should continue to account for these using their normal accounting policies (IFRS 16.6).

However, if the lease is considered onerous, IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' is applied (IAS 37.5(c)). An onerous contract is "a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it." A lease is onerous if:

- the building will be closed permanently; or
- the rent is above market rate as it is part of a loss-making cash generating unit (CGU).

It is important to check that the requirements for recognising a provision have been met ie:

- that an obligation exists at the reporting date because of a past event; and
- will result in a measurable transfer of economic benefits to settle the obligation.

Lease agreements normally cover this as they should set out clearly the rent payment requirements and oblige a lessee to make payment to the lessor.

Once the entity is satisfied that the contract is onerous and meets the conditions for recognising a provision, the provision is measured at the discounted value of the best estimate of the future cash outflows associated with a contract excluding:

- gains from the expected disposal of assets;
- potential reimbursement (recognised as a separate asset should requirements be met); and
- future operating losses.

Lease modifications

For lessors, when considering finance lease agreements, a modification that would not be considered to be an operating lease had it occurred at the inception of the lease, is accounted for prospectively over the remaining term of the lease in accordance with the principles in IFRS 9. (IFRS 9.5.4.3 as applied by IFRS 16.80(b)). For operating lease agreements, modification of the future cash flows results in a gain or loss on the income statement. (IFRS 16.87.)

For lessees, a lease modification is normally more complex. However, the IASB has released an amendment to IFRS 16 as an optional practical expedient under certain circumstances to allow preparers relief from assessing whether rent concessions occurring as a direct consequence of coronavirus are lease modifications and from applying the lease modification requirements to those concessions.

The practical expedient applies only to rent concessions that occur as a direct consequence of coronavirus and only if the following conditions are met: (IFRS 16.46B):

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

Practical impact and interpretation for preparers

There are potentially three key issues:

- Impaired lease assets – some lease agreements may now be impaired, given that some properties (eg restaurants) have been closed and are no longer generating revenue;
- Onerous lease agreements – leased items are not currently being used to their intended capacity and may have become onerous; and
- Lease modifications – where lessors and lessees have agreed to modify the terms of their lease (on a temporary or permanent basis) so that the lessee is able to continue to trade (and pay the rent) in the longer term once restrictions have been lifted.

Onerous lease agreements

Entities will need to address whether a lease has become onerous. This may be a simpler exercise where the asset itself represents core infrastructure of a CGU (for example, a restaurant premises or high street shops) but more difficult for cost centres which do not generate their own cash (for example, the back-office location for shops). This could also be difficult if entities have never undertaken these sorts of calculations and do not have the expertise in-house.

It is important to note that the requirements of IAS 10 '[Events after the Reporting Period](#)' apply to this consideration, so the judgements made should reflect only information available at the reporting date together with any 'adjusting events' after the reporting date.

Management should be aware that because this is a valuation exercise, the ethical standards for auditors preclude the entity's auditor from assisting in performing the calculation of the provision. Therefore, it is even more imperative that these items are dealt with as soon as practically possible to be able to source any assistance.

Lease modifications

In the interests of both the lessor and the lessee, lease contracts are being modified either permanently or temporarily. We have assumed that modifications made directly because of the pandemic wouldn't change the nature of the lease agreement (ie that a lessor will continue to account for a given lease as a finance or operating lease) or the nature of the leased asset (ie that there will be no decrease in the leased property).

Lessees should consider the most appropriate treatment of any modifications made to a lease agreement as a result of coronavirus, considering whether they are entitled to use the practical expedient in the amendment to IFRS 16.

Where an entity has chosen not to apply the practical expedient or does not meet the requirements for the practical expedient, the normal requirements relating to lease modifications as set out in IFRS 16 paragraphs 44-46 apply. In most cases the changes will not reflect partial or full terminations of the lease, and so the effect of the remeasurement of the lease liability is taken as an adjustment to the right-of-use asset (IFRS 16.46(b)).

Where an entity has chosen to and meets the requirements to apply the practical expedient, the discount or waiver is likely to be treated as a variable payment and hence the amount of the discount or waiver is recognised directly in profit and loss. Any change to the timing of the cashflows, where for example the rentals are reduced in the short term but are to be recovered through higher rentals during the lease period, the change is not taken to profit and loss but instead treated as lower reduction in the liability which is then paid off at a later date.

Our advice

- Entities will need to assess whether leased [assets have become impaired](#).
- When considering whether or not a right-of-use asset has been impaired, or to consider whether a lease meets the definition of an onerous contract, it may be necessary to consult a valuation specialist.
- For low value and short-term leases, consider whether the contract is onerous under IAS 37.
- Entities will need to assess whether they will meet the requirements and will apply the proposed practical expedient relating to rent concessions as a result of IFRS 16.

5. FINANCIAL INSTRUMENTS

5.1 Financial instruments

For entities that apply IFRS 9, coronavirus is likely to have a major effect on financial instruments including:

- the values calculated under the expected credit loss model for trade debtors. These are likely to become significantly more material because of the uncertainty over the key estimates underlying the calculation and the effect on the going concern conclusion;
- changes in the terms of financial instruments including modifications, derecognitions and transfers, to tie in with changes to the financial instruments themselves and changes in the market for variable interest rates; and
- the methods of calculating the fair value of financial assets and liabilities.

Whilst the IASB have not issued any special provisions or amendments relating to the effects of the coronavirus on IFRS 9, they have issued a [guidance note on the application of IFRS 9 in light of the coronavirus pandemic](#).

What does IFRS say?

Expected credit losses

Under the expected credit loss model, an entity should recognise a loss allowance for expected credit losses on most types of financial asset. Because expected credit losses consider the amount and timing of payments, an expected credit loss arises even if the entity expects to be paid in full but later than when contractually due (IFRS 9 B5.5.28).

Modification of terms

For financial liabilities the '10 per cent test' set out in IFRS 9 3.3.2 and IFRS 9 B3.3.6 should be followed. Where the present value of the future cash flows discounted at the old effective interest rate are more than 10% different to the carrying value of the liability, it's treated as an extinguishment. The decision may have a material impact as transactions treated as extinguishments will result in an immediate impact on the income statement, whereas the impact of transactions treated as modifications will be spread over the remaining life of the instrument.

For financial assets there is no specific guidance on the distinction between modification and extinguishment; however, if modified, a modification gain or loss is recognised in the income statement. This reduces the likely impact on the financial statements because for modifications the asset will be recognised at the net present value of the future cash flows discounted at the original effective interest rate (IFRS 9 5.4.3), whereas for extinguishments the new liability will have its own rate of interest.

Should financial assets and liabilities be shown as current or non-current?

Financial assets - Regardless of the contractual payment terms, a financial asset should be classified as current or non-current based on management's assessment at the reporting date of the likely inflow of cash. This can produce some accounting inconsistencies, as a financial instrument may be disclosed as a long-term debtor for one party and a short-term creditor for the other (particularly common for intra-group balances).

Financial liabilities – IAS 1 requires that an entity shall classify a creditor as due within one year when the entity does not have “an unconditional right to defer settlement of the liability for at least 12 months after the reporting period.”

If an entity is in breach of a covenant at the year end and the bank agrees to waive or modify the covenant but only confirms this after the year end, the liability should be shown as a current liability

because at the reporting date the entity was in default. The modification should be disclosed (but not adjusted for) in the financial statements.

Valuation of financial instruments held at fair value

IFRS 13 'Fair Value Measurement', which governs financial instruments measured at fair value, contains three levels of fair value hierarchy for measurement:

1. quoted prices in active markets (level 1 inputs);
2. measured using observable inputs (level 2 inputs); or
3. measured using unobservable inputs (level 3 inputs).

Where valuation methods are changed, disclosure is required of the changes and the reasons, and a significant amount of additional disclosure is required for Level 3 items.

Financial guarantee contracts

A financial guarantee contract is where the issuer of a contract is required to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due in accordance of the terms of debt instrument. Companies can choose whether to apply either IFRS 9 or IFRS 4 to these contracts.

Financial guarantee contracts are initially measured at fair value and are subsequently measured at the higher of the expected credit loss and the amount initially recognised. Alternatively, companies can choose to measure them at fair value.

General inter-group guarantees are dealt with under provisions and IAS 37.

Practical impact and interpretation for preparers

Expected credit losses

Liquidity risk is a key issue for most businesses because of the pandemic. The existence of extended credit terms, and other short-term measures ease liquidity, do not by themselves indicate a significant increase in credit risk. When applying the general model for expected credit losses management should continue to review their 12-month loss models where no significant increases in risk have been observed, but it will be more important than ever not to apply these models mechanically and to ensure that the underlying assumptions and judgements made reflect the current and forecasted future economic conditions and associated risk levels.

There will be an increasing number of cases where the credit risk of a financial asset has increased significantly due to the pandemic (IFRS 9 5.5.9-11). This will result in the lifetime expected credit losses being recognised.

For many companies that use the simplified method of assessing expected credit losses, for example for their trade debtors, it may no longer be applicable to use only historical losses to assess the expected credit losses. Instead companies should look at what other statistical information may be available, for example looking at past recessions and the impact on bad debts.

Modification of terms

In the present climate various modifications of agreements are being discussed between parties including extended credit terms, loan repayment holidays, and other changes. All such changes should be considered to identify whether the changes are, in effect, the extinguishment of the old instrument and the creation of a new one.

A common-sense approach should be taken to determining whether any changes should be accounted for as a modification or an extinguishment and management will need to ensure that their assessment is fully documented. Entities should first look to their own accounting policies for relevant guidance but failing that the '10% test' could be utilised in the context of all other more qualitative factors.

Should financial assets and liabilities be shown as current or non-current?

Any covenant breaches which occur due to coronavirus at the year-end should be shown as current liabilities. If the bank waives the covenant after the year-end this should be disclosed (but not adjusted for) in the financial statements.

Management's assessment of how a financial asset should be classified as current or non-current becomes more important because the users' assessments of cash recoverability in the current economic climate will be more sensitive than ever.

Valuation of financial instruments held at fair value

All items measured at fair value are expected to experience volatility as a result of the pandemic. The valuation methodology used for a given financial asset or financial liability may need to be substantially altered to reflect the changing market environment.

Some observable inputs are likely to be less readily obtainable, less reliable and/or less comparable than they previously were, meaning that instruments previously measured using observable inputs (Level 2) may need to rely increasingly on unobservable inputs (including risk adjustments). In some cases, this may mean that some instruments are reclassified as Level 3 on the valuation hierarchy for this reporting period.

Obtaining third-party evidence (from an active market or third-party sale of a similar instrument), at the reporting date could be incredibly difficult. This is likely to result in high variability in the range of reasonable fair value estimates.

Financial guarantee contracts

Where financial guarantee contracts are measured at the higher of expected credit losses and the amount initially recognised companies should re-estimate the expected credit losses taking into account the current circumstances. Where they are measured at fair value, they should obtain a valuation of the contract based on the current situation.

Our advice

- Allow time before authorising the financial statements. Financial instruments will require more thought from both preparers and auditors and are likely to involve the exercise of management judgement. You will need to evaluate the assumptions made against real evidence.
- The estimate of impairment via the expected credit loss method will be more important, and maybe more material, than ever. Management will need to carefully consider whether the impairment should be recognised in the current period ie if it's an adjusting event in accordance with IAS 10, or whether it only requires disclosure.
- Ensure all financial assets have been considered for expected credit losses including loans, trade debtors and intercompany balances.
- Where extended credit terms have been provided principally because of coronavirus, consider whether interest imputed for extended credit has now become material.

- The model for ECL calculations will need to be updated for the change to the risk levels as a result of coronavirus. The measurement of financial guarantee contracts should be reconsidered.
- Fully document the assumptions, estimates and judgements made and the reasons those were made as these are likely to be key risks.
- It is also important to consider [events after the reporting date](#) which is integral in determining whether any accounting adjustments are accounted for in the period or disclosed separately.

5.2 Hedge accounting

The coronavirus pandemic exposes entities to a wide range and magnitude of risks. In order to manage these entities could use a number of different hedging activities.

What does IFRS 9 *Financial Instruments* say?

Under IFRS 9 entities can apply hedge accounting to their qualifying hedging relationships with the result that assets, liabilities and firm commitments are measured on a basis different from their normal treatment under IFRS.

Applying hedge accounting

IFRS 9 describes the three types of hedging relationships:

- cash flow hedges, which can be applied to recognised assets and liabilities or highly probably forecast transactions;
- fair value hedges, which can be applied to recognised assets and liabilities or unrecognised firm commitments; and
- hedges of a net investment in a foreign operation.

Where there is a change in the relationship between the hedged item and the hedging instrument that arises from their underlying or risk variables, but the risk management objective is unchanged, an entity makes adjustments to the designated quantities in order to maintain the hedging ratio. This is known as rebalancing. (IFRS 9 6.5.5)

Hedge accounting must, however, be discontinued if the qualifying conditions for hedge accounting are no longer met (after taking into account any applicable rebalancing). This includes where the hedging instrument expires or is sold, terminated or exercised and where the criteria for hedge accounting are no longer met for all or part of the hedging relationship. IFRS 9 6.5.6)

On discontinuing hedge accounting for a cash flow hedge, the amount accumulated in the cash flow hedge reserve is either reclassified to profit or loss or included in the cost of any non-financial asset or liability, depending on the circumstances. (IFRS 9 6.5.11(d))

Cash flow hedge accounting for a highly probable forecast transaction must be discontinued when the hedged future cash flows are no longer expected to occur, and the cash flow hedge reserve should be reclassified to profit or loss immediately.

Where a forecast transaction that is no longer highly probable is still be expected to happen hedge accounting is discontinued but the amount accumulated remains in the cash flow hedge reserve until the future cash flows occur. However, if the amount is a loss and the entity expects that all or a portion

will not be recovered in one or more future periods, it should immediately reclassify the amount that is not expected to be recovered into profit or loss as a reclassification adjustment.

Hedge accounting should be discontinued prospectively from the date of cessation of the hedging relationship.

Hedge ineffectiveness

In a cash flow hedge, if the cumulative gain or loss on the hedging instrument is more than the cumulative change in the fair value of the expected future cash flows on the hedged item attributable to the hedged risk, then the difference is recognised in profit or loss as ineffectiveness.

Hedge accounting disclosures

IFRS 7 *Financial Instruments: Disclosures* requires entities to have extensive disclosures on hedge accounting. In particular:

- risk management strategy and how it is applied including, the hedging instruments used, how economic relationships are determined for the purposes of assessing effectiveness and how the hedging ratio and sources of ineffectiveness are established;
- how the hedging activities may affect the amount, timing and uncertainty of future cash flows including a profile of the timing of the nominal amount of the hedging instrument and a description by risk category of the sources of expected hedge ineffectiveness;
- a description of any forecast transaction for which hedge accounting had previously been used, but which is no longer expected to occur;
- the effect of hedge accounting on the statement of financial position, the statement of comprehensive income and the statement of changes in equity, giving information separately for hedged items and hedging instruments by risk factor and for each type of hedge, including carrying amounts, changes in value used as a basis for recognising ineffectiveness and cumulative adjustments and balances;
- the amount, if any, that was reclassified from equity to profit or loss for the period; and
- the amount, if any, of hedge ineffectiveness recognised in profit or loss (or other comprehensive income for certain fair value hedges of equity instruments) for the period.

Practical impact and interpretation for preparers

As a result of the current economic situation it is expected that hedge accounting might be affected in a number of ways including:

- changes to whether a forecast transaction is highly probable;
- changes to contractual terms of financial assets and liabilities impacting on eligibility to qualify as hedged items;
- changes in the underlying or risk variables that require rebalancing of the hedging ratio;
- differences in the effectiveness of the hedge; and
- more hedge instruments being used, and more hedge accounting being applied.

The realisation and timing of forecast transactions might change which will affect the application of hedge accounting eg a forecast purchase of raw materials being delayed or losses on hedging items no longer expected to be recovered.

Changes in entity and/or counterparty credit risk may result in increased ineffectiveness or the criteria for hedge accounting no longer being met and hedge accounting having to cease.

Hypothetical derivatives

Differences in the amount or timing of the hedged item and the hedging instrument give rise to hedging ineffectiveness. A common method of measuring ineffectiveness is the use of a 'hypothetical derivative' that mirrors the timing and amount of the hedged item.

Changes to the timing or amount of hedged items in response to economic conditions could require entities to redefine hypothetical derivatives to ensure hedge ineffectiveness is measured appropriately.

Hedge accounting

Highly probable criteria

If there is a change in the quantity or timing of future delivery or payment, entities need to evaluate whether the original highly probable forecast transaction still exists. Significant judgement may be involved in determining whether the transaction is the originally designated transaction or a different one.

If the highly probable forecast transaction does not exist in full or in part anymore, entities need to partially or fully terminate hedge accounting prospectively and either reclassify the related amounts from the cash flow hedge reserve to profit or loss or retain them in the cashflow hedge reserve until the future cash flows occurs or until any loss accumulated in that reserve is not expected to be recovered.

Hedging relationship no longer exists

If the expected hedged cash flows arise earlier than originally forecasted and the hedging instrument's maturity is longer than the timeframe of the hedged cash flows there will no longer be a hedging relationship to which to apply hedge accounting. Fair value changes on the hedging instrument that arise between the date of the forecast transaction occurring and the maturity of the instrument will be recognised in profit or loss.

Where the changes to timings or quantities are such that the original forecast transaction no longer exists but a new highly probable forecast transaction is expected, it may also be possible to designate the hedging instrument in a new hedging relationship if the criteria for hedge accounting are met. However, as the fair value of the hedging instrument will not be nil at the inception of the new hedging relationship there will be ineffectiveness. Care may be needed in documenting the hedging relationship, particularly if the quantity of the hedge item has changed from the original, and judgement may be needed to determine whether there is an economic relationship between the new hedged item and the original hedging instrument.

Hedge ineffectiveness

When entities conclude that there is only a delay in the forecast transaction, but it is still highly probable, there will be an impact on the recorded ineffectiveness and the terms of any hypothetical derivative used to measure ineffectiveness may need to be revised. If the maturity of the hedging instrument was originally longer than the duration of the forecast transaction, entities might need to reduce the level of ineffectiveness recorded in profit or loss. If the hedging instrument terminates before the forecast transaction happens then hedge accounting will cease.

Credit risk

When a hypothetical derivative is used to measure ineffectiveness the critical terms of the hypothetical derivative match those of the hedged item (eg notional, underlying, maturity, repayment periods) and the hypothetical derivative's counterparty is free from credit risk.

Therefore, a significant increase in the credit risk of either party might cause additional ineffectiveness because:

- the change of the fair value of the derivative instrument would be affected by the credit deterioration; and
- the change of the fair value of the hedged item would not be affected, or vice versa.

Where there is a significant change in the credit risk of either party the reporting entity will need to consider whether the criteria for hedge accounting continue to be met, as hedge accounting is only permitted where the effect of credit risk does not dominate the value changes that result from the economic relationship between the hedged item and the hedging instrument.(IFRS 9 6.4.1 (c) (ii))

Whether a change in credit risk results in dominance of the value changes will be a matter of judgement and can arise even when credit risk is excluded from the hedging relationship, for example if interest cash flows are no longer expected to occur because of credit deterioration.

Disclosures

Entities need to evaluate what additional disclosures should be made as a result of the changes in the expected cash flows, credit risk and hedge ineffectiveness.

Our advice

- Evaluate the appropriateness of current risk management strategies, objectives and the potential implications for hedge accounting.
- Consider what further hedging strategies should be taken to mitigate any potential risks.
- Evaluate the entity's ability to prepare forecasts and consider whether the forecast transactions are still highly probable or whether the hedge accounting need to be discontinued.
- Revise the terms of hypothetical derivatives to reflect changes to the timing and quantity of hedged items.
- Evaluate credit risk to assess its potential impact on whether the hedging criteria continue to be met and on hedge ineffectiveness.
- Consider whether any hedging ratios require rebalancing.
- Reconsider any further potential changes that mean the criteria for hedge accounting are no longer met and or that result in additional sources of ineffectiveness in the hedging relationships.
- Assess what further information should be gathered for disclosure purposes.

6. PROVISIONS, CONTINGENT LIABILITIES AND ASSETS

6.1 Provisions, onerous contracts and insurance recoveries

The impact of coronavirus may mean that entities need to account for new provisions for restructuring costs, amend current provision estimates, consider if contracts have become onerous and deal with recognising and measuring insurance policies.

What does IFRS say?

IAS 37.10 states that an entity should recognise a provision when:

- the entity has an obligation (legal or constructive) at the reporting date as a result of a past event;
- it is probable (ie more likely than not) that the entity will be required to transfer economic benefit in settlement; and
- the amount of the obligation can be estimated reliably.

The provision should be measured at the best estimate of the amount required to settle the obligation at the reporting date.

IAS 37 also says that:

- an entity should recognise a provision for restructuring costs only when it has a legal or constructive obligation at the reporting date to carry out the restructuring (examples 5A and 5B in the appendix to IAS 37 provide guidance on closures announced before and after the year-end);
- provisions for future operating losses should not be recognised (IAS 37.63);
- the present obligation under an onerous contract should be recognised and measured as a provision (IAS 37.66); and
- no obligation arises for the sale of an operation until the entity is committed to the sale, i.e. there is a binding sale agreement (37.78).

Practical impact and interpretation for preparers

Entities may need to amend current provision estimates (discount rates, warranty and other returns rates etc) as the underlying assumptions are likely to have changed as a result of current market conditions.

Restructuring provisions

Where a plan to close or downsize the business has been made and announced before the end of the reporting period, entities may need new provisions for restructuring costs.

When recognising a provision for restructuring the key consideration is whether:

- a detailed formal plan has been made; and
- it has raised a valid expectation in those affected by starting implementation or announcing the plan's features before the end of the reporting period.

Where a restructuring plan will take a long time to complete, with varying stages, only those stages that the entity is committed to at the reporting date should be provided for. For example, if plans included redundancies immediately, but the potential closure of a site in the next year, only redundancy costs should be included at the reporting date.

Only those costs which are directly related to the restructuring can be included in the provision ie those that are both necessarily required by the restructuring and not associated with ongoing activities.

Provisions for future trading losses / costs

Under the IAS 37 and the going concern accounting principles, other than provisions for onerous contracts, businesses must not book provisions for future trading losses as such costs are only booked when incurred.

Onerous contracts

Entities may need to consider if contracts in place at the reporting date have become onerous ie the cost of fulfilling the contract is expected to outweigh the benefits.

At the commencement of contracts parties would expect to receive benefits that are greater than the cost of executing, however due to coronavirus, the obligations of performing that contract may now outweigh the benefits, for example:

- raw material costs may have increased yet the sales price is fixed, or staff costs have increased due to restrictions in place; and
- penalty clauses in revenue contracts for non or late delivery have been triggered.

If on review of the contract the cost outweighs the benefit, a provision should be recognised for the excess cost. Businesses should however ensure that provisions for future general operating losses across the business are not included.

Insurance recoveries

Some entities will have insurance policies that may provide a reimbursement for business interruption costs or to settle part or all of a provision. Whilst these should be considered at the same time as the provision, they will be recognised and measured separately.

When some or all of the amount required to settle a provision may be reimbursed (eg through an insurance claim for business interruption), the entity should only recognise the separate asset when it is virtually certain that the entity will receive such reimbursement. To recognise the recovery asset, the value of the reimbursement does not need to be virtually certain, only that the entity is virtually certain to receive it i.e. the reimbursement qualifies for recognition as an asset in its own right.

Where an entity is virtually certain of reimbursement then a reliable prudent estimate should be recognised as a separate asset on the balance sheet. Within the profit and loss account a net amount may be presented, being the anticipated cost of the obligation less the reimbursement.

If recovery is only probable, then a contingent asset should be disclosed.

Our advice

- Keep up to date with government announcements and potential finance assistance before determining whether restructuring is required.
- If a restructuring plan is agreed, consider if it triggers the need for an [impairment review of assets](#) linked to that division.
- Review the contracts in place to consider if any can be cancelled or re-negotiated without penalty to relieve the entity of any obligations eg force majeure. If they cannot be cancelled or re-negotiated without penalty, then consider whether the penalties are in the best interests of the entity and then update projects and recognise a provision as necessary.
- Consider assumptions and estimates used in current provision calculations to ensure these are still applicable given changes in the current climate, for example returns rates for online orders.

- Consider current business insurance cover to determine whether a potential claim against the costs can be made. This might involve detailed discussions with insurance brokers over the terms of insurance and over what period a loss needs to be suffered before a claim is considered.
- Provide clear and relevant disclosures about the provision including the expected amount, timing, and any uncertainties.

6.2 Contingent liabilities and assets

Given the degree of uncertainty surrounding the impact of coronavirus, entities will need to be mindful of potential obligations or assets that have never been considered as part of the normal reporting cycle but now require disclosure in the accounts, even though they are not recognised on the balance sheet.

What does IFRS say?

IAS 37.10 states that a contingent liability is either:

- a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
- a present obligation that arises from past events but is not recognised because:
 - it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
 - the amount of the obligation cannot be measured with sufficient reliability.

If the possibility of an outflow of resources is remote, then no disclosure is required.

IAS 37.10 states that a contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

A contingent asset is disclosed where an inflow of economic benefits is probable.

Practical impact and interpretation for preparers

Contingent liability

Assuming that the entity has a legal or constructive obligation at the reporting date, initially it will be necessary to determine whether this obligation should be recognised in the accounts as a provision, a contingent liability or requires no mention.

Situation	Provision?	Contingent liability?
Event occurs before the reporting date, future settlement outflow probable (ie >50%)	Yes	No
Event occurs before the reporting date, future settlement outflow possible (ie <50%)	No	Yes (disclose unless likelihood of outflow is 'remote')
Event occurs before the reporting date; future settlement outflow depends on future uncertain event	No	Yes (disclose unless likelihood of outflow is 'remote')
Event occurs before the reporting date; future settlement outflow cannot be estimated reliably	No	Yes (but expected to be rare)
Event occurs after the reporting date	No	No (but may be disclosable as a non-adjusting post-balance sheet event)

- One of the key considerations is the entity's reporting date and reference to "past event", which is critical when considering both a possible obligation and a present obligation. Past events need to be before the reporting date for any contingent liability to be disclosed and therefore defining the past event is important. Whilst coronavirus might be the underlying event, it is only subsequent future events that are outside of the control of the entity that determines if a contingent liability is disclosable. For example, if the entity couldn't fulfil orders before the reporting date due to coronavirus but customers only made a legal claim in this regard after the reporting date, if there is a possible future outflow, then a contingent liability disclosure would be needed.
- If the event is determined to occur before the reporting date, then unless the future outflow is probable ie more than 50% (in which case it will be recognised as a provision), a contingent liability disclosure is likely to be required.

Disclosures should detail an estimate of the financial effect; an indication of uncertainties to the amount or timing; and the possibility of any reimbursement. If it is impracticable to detail any of these that should be stated. Contingent liability disclosure is often a sensitive area given disclosure may (if option b is applicable) be interpreted by users that the entity accepts there is a present obligation as a result of a past event. However, whilst clients may challenge disclosure on seriously prejudicial grounds, the standard still requires some disclosure (IAS 37.92).

Entities may have put in place financial guarantee contracts, such as intercompany cross guarantees or arrangements, giving rise to joint and several liability including some where the likelihood of being called upon would normally be remote or have otherwise been overlooked (eg all members of a VAT group are jointly and severally liable to HMRC). Entities should assess whether these financial guarantee contracts should be accounted for in accordance with IFRS 9 or IAS 36. If they are under IAS 37 they should assess the possible or present obligations; and the disclosures required under IAS 37.84-92.

Contingent assets

As a result of various forms of financial assistance and the potential for insurance recoveries, consideration of contingent assets is an area that many entities will need to actively consider.

Like contingent liabilities, the key will be determining where the past event falls with reference to the reporting date. For example, an insurance claim may relate to the event of coronavirus but may only be triggered by certain other events that happen after the reporting period eg loss of future bookings or margins falling below a specific level. These events after the reporting period would not trigger a contingent asset disclosure.

Where it's shown that the potential asset arises as a result of a past event, and the inflow of economic benefits arising from that event is probable, disclosure of a contingent asset will be required describing the nature of the contingent asset and an estimate of the financial effect.

If an economic inflow is virtually certain then the related asset is no longer a contingent asset, and it should be recognised on the balance sheet as an asset.

Our advice

- Carefully consider whether the specific event or action occurs before or after the reporting date.
- Where any financial guarantee contracts are within the scope of IAS 37 the entity should consider the likelihood of them being called in, and hence what disclosure is required, eg contingent liability. Other financial guarantee contracts are dealt with by IFRS 9. (see Financial Instruments section)

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- As more government guidance is released, and as business operations return to normal, entities should continually assess if there are potential liabilities that are possible but not probable. These may arise from changes to terms with suppliers or employees.
 - Revisit accounts disclosures to ensure they contain the most up to date information relevant to the circumstances.

7. STATEMENT OF CASH FLOWS

7.1 Statement of cash flows

During this period of economic uncertainty, cash is as important as ever. Entities will be monitoring cash flows on a more regular basis and it is likely that the users of financial statements will focus on the statement of cash flows to understand the movements in and utilisation of cash and cash equivalents over the year.

What does IFRS say?

IAS 7 provides guidance on the creation of a statement of cash flows stating that it should:

- reconcile the movement in cash and cash equivalents year on year;
- group cash flows into three headings: operating, investing and financing activities;
- report cash flows from operations using either the direct method (i.e. gross cash receipts and gross cash payments) or the indirect method (i.e. by making adjustments to profit or loss); and
- consist of two main supporting notes:
 - a breakdown of the components that make up cash and cash equivalents and reconciliation to amounts in the statement of financial position; and
 - changes in liabilities arising from financing activities (which can be a reconciliation between opening and closing balances in the statement of financial position).

Practical impact and interpretation for preparers

The main impact on cash flow for entities will be the receipt of money from the various Government schemes.

Entities will have to decide whether to classify the cash receipts from the government as:

- operating activities - the principal revenue-producing activities of the entity and other activities that are not investing or financing;
- investing activities - the acquisition and disposal of long-term assets and other investments not included in cash equivalents; or
- financing activities - activities that result in changes in the size and composition of the contributed equity and borrowings of an entity.

Typically, government grants are classified as cash flows for operating activities as they are cashflows used to carry on operations. IAS 7.15 states that “cash advances and loans made by financial institutions are usually classified as operating activities since they relate to the main revenue-producing activity of that entity.

Our advice

- There should not be a significant change in the mechanics for the preparation of a statement of cash flows, but it is likely to be an area of increased scrutiny by users of the accounts.
- Entities should:
 - separate material, one-off items out in the statement of cash flows (for example a significant one-off loan cash inflow) so a user of the accounts can understand these key cash-flows;

- separate cash inflows and outflows on loan refinancing in the year;
- consider the impact of interest accruals on loans and financing to ensure any non-cash movement is correctly adjusted and not reflected as an interest cashflows;
- separate non-cash interest charges from cash interest charges if discounting has been applied through interest; and
- carefully review foreign exchange movements in the P&L for cash and non-cash movements, especially within international groups.

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