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COVID-19: IMPACT ON ACCOUNTING TRANSACTIONS AND FINANCIAL REPORTING

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Editorial

I take this opportunity to welcome you to the second quarter of the year 2020!

We began the year with great expectations and hopes. However, as the first quarter of the new year drew close to the end, the impact of the Coronavirus (COVID-19) pandemic started to hit closer home. The first case of the virus was recorded in the country. This began an accelerated turn of events with sudden measures to mitigate the spread of the virus being put in place by the government.

This resulted into lock-down and other containment measures being imposed in the country, including subsequent travel restrictions and social distancing measures. This has impacted the way the Institute operates in a tremendous way, including the effect on CPD events and curtailment of learning through the usual physical delivery approaches.

Consequently, it cannot be overemphasized that COVID-19 is presenting unexpected and extreme challenges for organizations of all sizes and sectors across the world. It is quickly changing how entities operate and how individuals live and work. As a knowledge convener, ICPAK has continued to devise innovative ways of passing the knowledge to its members and practitioners so that they are up to date with the current developments affecting the profession.

It is with this understanding that the Institute has published this dedicated technical newsletter with an update on how the virus has impacted the way to account and report economic transactions across various sectors of the economy. This ranges from the going concern considerations, effects after the reporting period, dealing with financial instruments, all the way to the impact on lease contracts.

Further updates will be provided through our various communication and learning channels as the Institute continues to assess and internalize the evolving COVID-19 pandemic situation. I hope you find the updates in this edition of the newsletter useful to you as you apply the insights into your work during this unprecedented moment.

Enjoy the reading and remember to keep safe!

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COVID-19: Impact on accounting transactions and financial reporting

The Institute has all along strived to effectively play its role in actualizing the above mandate and will continue to do so in collaboration with other regulators and stakeholders. This continues to happen even during moments of crisis such as under the current circumstances caused by the coronavirus 2019 (COVID-19) pandemic.

Covid-19 Effect

The COVID-19 pandemic is affecting economic and financial markets, and virtually all industries are facing challenges associated with the economic conditions resulting from efforts to address it. For instance, many entities in the travel, hospitality, leisure, and retail industries have seen sharp declines in revenues due to regulatory and organizational mandates (e.g. "shelter-in-place mandates", school closures, among others) and voluntary changes in consumer behaviour e.g. "social distancing".

As the pandemic increases in both magnitude and duration, entities are experiencing conditions often associated with a general economic downturn.

This includes, but is not limited to, financial market volatility and erosion, deteriorating credit, liquidity concerns, further increases in government intervention, increasing unemployment, broad declines in consumer discretionary spending, increasing inventory levels, reductions in production because of decreased demand, layoffs and furloughs, and other restructuring activities.

The continuation of these circumstances could result in an even broader economic downturn which could have a prolonged negative impact on an entity's financial results. It is against this backdrop of the unfolding events around COVID-19 that this paper highlights certain key financial reporting and accounting considerations related to conditions that may result from the devastating pandemic. The significance of the individual issues discussed below will of course vary by industry and by entity, but it is believed that the following topics will be the most pervasive and challenging to address.

COVID-19: Impact on accounting transactions and financial reporting

1. Going concern

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

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

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

i Whether the forecast performance would result in an adequate level of headroom over the entity's available borrowing facilities and compliance with relevant loan covenants; and

ii The availability of sufficient committed borrowing facilities for the foreseeable future and whether there are indicators that the lending counterparty will be unable to provide this funding.

In the current situation, the assessment is made more difficult given the uncertainties about the impact of the COVID-19 pandemic, the extent and duration of social distancing measures in effect in many jurisdictions and the impact on the economy. Management should consider the impact of these matters on the entity's specific circumstances, in

particular current and potential cash resources including access to existing and new financing facilities, and factoring and reverse factoring arrangements. Access and use of such facilities and arrangements should be disclosed.

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

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

When management is aware of material uncertainties that cast a significant doubt on the entity's ability to continue as a going concern, IAS 1:25 requires the entity to disclose those material uncertainties in the financial statements. The disclosure should be specific to the entity's own situation, for example explaining how and when the uncertainty may crystallize and its impact on the entity's resources, operations, liquidity and solvency.

Given the current uncertainty and the variety of outcomes still possible related to the course of the pandemic and its adverse impact on economies all over the world, entities will need to consider a wide range of factors related to current and expected profitability, among other things. There may be cases when an entity concludes, after having considered all relevant information, including the feasibility and effectiveness of planned mitigation, that there are no material uncertainties that cast substantial doubt about its ability to continue as a going concern requiring disclosure under IAS 1:25. However, in this current climate, reaching that conclusion will often involve significant judgements around the range of outcomes to consider and the probabilities assigned to those outcomes. Furthermore, the range of possible outcomes and their impact on the entity's future operations may be broad, meaning that assigning more or less weight to possible outcomes could make a difference in the entity's conclusion regarding the existence of material uncertainties.

IAS 1:122 requires disclosure of the judgments made that have the most significant impact on the amounts recognized in the financial statements. IAS 1:122 also requires disclosure of the significant judgements which the entity has made to reach the conclusion that no disclosure of material uncertainties is required under IAS 1:25, especially when other reasonable judgements may have resulted in a different conclusion.

When management is aware of material uncertainties that cast a significant doubt on the entity's ability to continue as a going concern, IAS 1:25 requires the entity to disclose those material uncertainties in the financial statements.

This is consistent with the conclusion reached by the IFRS Interpretations Committee in the July 2014 IFRIC Update that disclosure of significant judgements is required when an entity concludes there is no material uncertainty regarding its ability to continue as a going concern but reaching this conclusion involved significant judgement. Such disclosure is important to provide users of the financial statements with sufficient information to understand the pressures on liquidity, viability and solvency.

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

2. Events after the end of the reporting period

Whilst the events stemming from COVID-19 are extremely volatile, entities will nevertheless be required to consider conditions as they existed at the reporting date when evaluating subsequent events.

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

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

Often the "events" are (1) company-specific; and (2) associated with a specific account that permits a more precise analysis. However, sometimes the "events" are macroeconomic in nature (such as those resulting from COVID-19) and have a pervasive impact on many estimates in a set of financial statements which may make it difficult to ascertain whether such conditions "existed" at the reporting date.

The full impact of the COVID-19 pandemic on short-term, medium-term, and long-term economic activity is still unknown, and major developments are occurring frequently. However, COVID-19 will be a factor in an entity's analysis of estimates made in the preparation of the financial statements, including those related to the expected credit loss on receivables, inventory obsolescence, impairment analyses, variable and contingent consideration

The estimate does not need to be precise. It is preferable to provide a range of estimated effects as an indication of impact to not providing any quantitative information at all.

estimates, and other factors. *Whilst the events stemming from COVID-19 are extremely volatile, entities will nevertheless be required to consider conditions as they existed at the reporting date when evaluating subsequent events.*

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

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

The estimate does not need to be precise. It is preferable to provide a range of estimated effects as an indication of impact to not providing any quantitative information at all. However, where quantitative effect cannot be reasonably estimated, qualitative description should be provided, along with a statement that it is not possible to estimate the effect.

3. Statement of profit or loss

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

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

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

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

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

The impacts of COVID-19 are macroeconomic and affect all entities. Whilst the current environment may be unprecedented, it results from a series of events globally that are likely to have a wide range of potentially long-term consequences. As discussed above, some of the impacts will give rise to discrete losses or expenses, such as those related to impairment losses or restructuring plans.

Any additional information that entities seek to include to explain the impact of COVID-19 should instead be included in the notes to financial statements or other financial communications.

comparative period. In fact, such "pro forma" presentation would not comply with the requirements of IAS 1:99 to present an analysis of expenses using a classification based on either their nature or their function. Likewise, it would not be appropriate to consider that the function of costs presented according to function has changed due to the effects of COVID-19 (for instance depreciation in respect of factory or premises that are closed for a period of time due to government measures).

Any additional information that entities seek to include to explain the impact of COVID-19 should instead be included in the notes to financial statements or other financial communications. However, consideration should be given to regulatory and other requirements related to the provision of alternative or non-IFRS measures.

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

Many of the impacts of COVID-19 on an entity are likely to form part of the entity's normal activities and thus should be considered to form part of the underlying business performance and should not be excluded from 'underlying' results presented in the statement of profit or loss.

4. Financial Instruments

Allowance for expected credit losses (ECL)

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

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

i An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;

ii The time value of money; and

iii Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

The impact of COVID-19 on ECL will be particularly challenging and significant for banks and other lending businesses. The effect could also be significant for non-financial corporates. This is because ECL does not only apply to loans but also applies to many investments in interest bearing financial assets (e.g. bonds and debentures), trade receivables, contract assets, lease receivables, issued loan commitments and issued financial guarantee contracts. The extent of these exposures in non-financial corporates may also be greater in individual company financial statements due to intra-group transactions such as intra-group loans or guarantees provided by the reporting entity on other entities' debt obligations. Under the general model for impairment ECL is recognized for 12-month ECL or lifetime ECL dependent on whether there has been a significant increase in credit risk ("SICR") of a financial asset (or other exposure) since initial recognition (a "staging" analysis). This analysis requires the estimate of lifetime probability of default at initial recognition of a financial asset and at each reporting date thereafter, based on an assessment of forward-looking information which is particularly challenging given uncertainties of the eventual impact of COVID-19.

Despite the challenges, entities are still required to make estimates based on reasonable and supportable information that is available without undue cost or effort at the reporting date. Sources of such information can include information used in the entity's ongoing credit evaluation processes and financial forecasts for economies or industries that are becoming available over time. It is not expected that the difficulties associated with making estimates and assumptions in these uncertain times

would be a basis for entities not to update ECL measurements.

Trade receivables

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

In practice the measurement of ECL for portfolios of trade receivables does not usually require complex analysis. The average historical credit losses on a large group of trade receivables with shared risk characteristics may until now have been a reasonable estimate of the probability-weighted expected loss amount. A common example of a loss rate approach used for trade receivables is a provision matrix developed using historical credit loss experience. IFRS 9 requires that historical loss rates are adjusted as appropriate to reflect current conditions and estimates of future economic conditions. However, until now such adjustments may have been limited.
COVID-19 will require entities to revisit the provision matrix approach and consider the following:

- The amount and timing of the expected credit losses as well as the probability assigned to alternative scenarios must be based on reasonable and supportable information that is available without undue cost or effort at the reporting date without the use of hindsight. Entities will need to reconsider their previous credit loss expectations if these are based on unadjusted historical experience that is not reflective of the current market conditions and forward-looking information. In many cases, this may require significant judgement given the uncertainties present (e.g. financial viability of debtors, levels of government support, etc.).
- There may be a lack of relevant historical data reflecting sufficiently adverse economic conditions on which to base the estimate. An entity may already be observing the default of debtors and will need to determine the impact that these observations have on expectations of recoveries and future default of other debtors.
- Operational disruption experienced by both customers and suppliers as well as moratoriums on debt repayments or enforcement actions may result in delays in the processing and settlement of transactions. Short-term trade receivables are recognized at their transaction price and consequently have an effective interest rate (EIR) of nil, and therefore a delay in collection will not result in an increase in the reported loss allowance (measured by discounting expected shortfalls at the asset's EIR). However, these delays introduce uncertainty as to whether the full amount will be recovered and this uncertainty is required to be reflected in the ECL measurement. In some cases the delays may be considered temporary. This may mean that previously determined loss rates for the individual "days-past-due" categories included in an entity's provision matrix may not be reflective of expected recoveries.
- Greater volatility in potential economic conditions, even over the relatively short exposure period of trade receivables, will increase the importance of considering multiple economic scenarios in determining expected loss rates.
- With greater incidence of individual receivables in default, loss rates may need to be applied to individual receivables or sub-portfolios of receivables if the receivables in the overall portfolio no longer exhibit similar credit risk characteristics. This may result in a requirement to apply the provision matrix at a more granular level or to assess a greater number of receivables on an individual basis. Entities should ensure that any estimate of ECL on an individual debtor reflects a probability-weighted outcome and that an appropriate loss allowance continues to be recorded on a collective basis for all receivables that are not assessed individually.

The above considerations also apply to contract assets.

Other receivables

Although a staging analysis may not be required for trade receivables and contract assets, most entities will have some financial assets that are accounted for under the general model rather than the simplified model for which a staging analysis will be need-

ed. For example, intercompany receivables, lending balances with entities outside the group and receivables relating to business disposals. The impact of forward-looking information and multiple economic scenarios is also likely to be more significant for such assets.

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

Credit Enhancements

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

Amounts receivable from non-integral credit enhancements are not included in ECL measurement and are recognized separately.

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

Issued financial guarantee contracts

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

Fair value measurements

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

Liquidity risk management

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

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

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

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

Entities should consider how the use of working capital enhancement or management techniques is reflected in the entity's disclosure of its liquidity risk

management as required by IFRS 7 Financial Instruments: Disclosures. Entities should also consider the specific disclosure requirements for transfers of financial assets as required by IFRS 7 when financial assets are sold to fund working capital needs, and the accounting policies and judgements applied in determining the balance sheet and cash flow statement presentation of amounts due and paid when supplier finance and reverse factoring arrangements are used.

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

Classification of financial assets

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

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

Some entities that have assets that are held under a "held to collect and sell" or "held to sell" business model may find that previously anticipated sales are no longer expected to take place due to a reduction in asset values or in the liquidity of the relevant market.

IFRS 9:B4.4.3 states that neither a change in intention related to a particular asset (even in circumstances of significant changes in market conditions), nor a temporary disappearance of a particular market represent a change in an entity's business model.

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

Debt modifications

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

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

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

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

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

Changes in estimated cash flows

COVID-19 may result in a change in expectations regarding the exercise of prepayment, extension or conversion features in various debt agreements. When such features are accounted for as bifurcated embedded derivatives or when the entire instrument is measured at fair value through profit or loss (FVTPL), changes in the likelihood of those features being exercised will be reflected in the fair valuation.

When such features are accounted for as part of a host debt instrument that is measured at amortized cost, remeasurement adjustments recognized in profit or loss may still arise as the revised expected cash flows are discounted at the instrument's original effective interest rate. When a conversion feature is classified as equity, changes in expectations regarding its exercise would have no impact on the amount originally recorded in equity.

Financial vs non-financial assets and liabilities

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

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

For the payer of the prepayment this may result in the recognition of a non-financial asset because it expects to receive the non-financial item and it meets the own use requirements in IFRS 9. Likewise, the receiver of the cash may recognize a non-financial liability because it expects to deliver the non-financial item and it meets the own use requirements in IFRS 9. Expected cash settlement of such contracts would result in them being treated as a financial instrument and classified as a financial asset or financial liabilities.

5. Revenue from contracts with customers

Business disruptions associated with the COVID-19 pandemic may prevent an entity from entering into customer agreements by using its normal business practices, which may make the determination of whether it has enforceable rights and obligations challenging. In addition, because many of its customers are experiencing financial difficulties and liquidity issues, an entity may need to develop additional procedures to properly assess the collectability of its customer arrangements and consider changes in estimates related to variable consideration (e.g. because of greater returns, reduced usage of its products or services, or decreased royalties).

To help its customers or to provide incentives for them to continue purchasing its goods or services, an entity may (1) revise its agreements to reduce any purchase commitments; (2) allow customers to terminate agreements without penalty; or (3) provide price concessions, discounts on the purchase of future goods or services, free goods or services, extended payment terms or extensions of loyalty programmes.

Further, because the entity itself may be experiencing financial difficulties and supply disruptions, it may (1) request up-front payments from its customers; (2) delay the delivery of goods or services; (3) pay penalties or refunds for failing to perform, not meeting service-level agreements, or terminating agreements; or (4) incur unexpected costs to fulfil its performance obligations.

Therefore, as a result of the changes in circumstances experienced by both an entity and its customers due to the COVID-19 pandemic, an entity may need to consider the following when assessing revenue from contracts with customers:

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

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

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

- Collectability—A contract with a customer does not exist unless it is probable that the entity will collect substantially all the consideration to which it will be entitled in exchange for the promised goods or services that will be transferred.

  The collectability of that consideration should be assessed after taking into account expected price concessions (including implied concessions), which are evaluated as variable consideration, even if those concessions are provided as a result of credit risk.

  In addition, whilst the collectability analysis is performed at the individual contract level, an entity may look to a portfolio of similar contracts (e.g., by risk profile, size of customer, industry, geography, etc.) in its assessment.

  For example, if it is probable that an entity will collect substantially all the consideration for 90 per cent of a portfolio of similar contracts, and the entity is unable to identify specific contracts for which consideration is unlikely to be collected (i.e. the risk is the same for all contracts), the entity may conclude that it has met the collectability threshold for all the contracts in the portfolio.

  However, an entity should not ignore evidence related to specific contracts that do not meet the collectability criterion. In that circumstance, it should evaluate those specific contracts separately.

  An entity should not reassess whether a contract meets the criteria in IFRS 15:9 after contract inception unless there has been a significant change in facts and circumstances. If the impacts of the COVID-19 pandemic result in a significant deterioration of a customer's or a portfolio of customers' ability to pay, the entity should reassess collectability.

  For instance, if a customer experiences liquidity issues or a downgrade in its credit rating, the entity would need to carefully evaluate whether those circumstances are short-term in nature or result in a determination that it is no longer probable that the customer has the ability to pay.

  Because of the significant uncertainty associated with the effects of the pandemic, it is important for the entity to document the judgements it made and the data or factors it considered. If the entity concludes that collectability is not probable, a customer contract no longer exists and, thus, the entity can no longer recognize revenue under IFRS 15's 5-step model. If collectability becomes probable in a subsequent period and the other criteria in IFRS 15 are met, the entity can begin to recognize revenue again.

  See the discussion on contract enforceability above for conditions that need to be met to recognize revenue when an enforceable contract does not exist.

- Contract modification—An entity may modify its enforceable rights or obligations under a contract with a customer. For example, the entity may grant a price concession to a customer. In that circumstance, the entity should consider whether the concession is due to the resolution of variability that existed at contract inception (i.e. a change in transaction price associated with variable consideration) or a modification that changes the parties' rights and obligations.

  A price concession that is provided solely as a result of the COVID-19 pandemic most likely represents a modification that changes the par-

ties' rights and obligations. In addition, an entity may modify the scope of a contract (e.g. by reducing minimum purchase commitments). If the modification adds goods or services to the contract, the entity should first evaluate whether the modification is accounted for as a separate contract in accordance with IFRS 15:20.

However, if the only change to a contract is a reduction of the transaction price or the modification is not otherwise a separate contract applying IFRS 15:20, the entity should evaluate the guidance in IFRS 15:21 to determine whether the modification should be accounted for as (1) a termination of the old contract and the creation of a new contract because the remaining goods or services are distinct (which results in prospective treatment);

(2) a cumulative catch-up adjustment to the original contract because the remaining goods or services are not distinct; or (3) a combination of (1) and (2). If all performance obligations have been satisfied, any price concession would be treated as a change in transaction price in accordance with IFRS 15:87-89.

- Variable consideration—Variable consideration includes, among other things, rebates, discounts, refunds (including for product returns), price concessions and penalties. In accordance with IFRS 15:56, an entity should only include amounts of variable consideration in the transaction price if (or to the extent that) it is highly probable that doing so would not result in a significant reversal of cumulative revenue recognized when the uncertainty related to the variable consideration is resolved.

  Further, an entity must update its estimated transaction price in each reporting period. The entity may need to consider any expected changes in (1) its ability to perform; and (2) customer behaviour that results from deteriorating economic conditions. For example, an entity may need to consider updating its estimated transaction price if it expects an increase in product returns, decreased usage of its goods or services or decreased royalties, or to potentially pay contractual penalties associated with its inability to perform (e.g. the inability to deliver goods or services on a timely basis or to meet service-level agreements).

  If there is a reduction in the estimated transaction price, a change in estimate may result in the reversal of revenue for amounts previously recognized as variable consideration (e.g. as a result of an increase in return reserves). Because of the significant uncertainty associated with the pandemic's effects on an entity and its customers, it may be challenging for the entity to make appropriate estimates of variable consideration.

  Therefore, in a manner similar to its assessment of contract collectability, an entity must document the judgements it made and the data or factors it considered, and ensure it has carefully considered how to constrain estimates of variable consideration.

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

  Additionally, when it is possible that future penalties will be triggered under a contract (e.g. as a result of the late delivery of a good or service), these will reduce the estimate of the transaction price to be allocated between performance obligations, other than in cases where it is highly probable that the penalties will not arise, or where they are too small to result in a significant reversal of revenue.

  When a reduction to the transaction price is required, it will be important to consider the guidance in IFRS to determine whether that variable consideration should be allocated to specific performance obligations (e.g. the particular deliveries that are expected to be late) or to all performance obligations.

- Material right—To mitigate any decline in sales,

an entity may offer its customers sales incentives, including discounts on future goods or services. In this circumstance, the entity should evaluate whether a sales incentive on the purchase of future goods or services represents;

(1) a material right in accordance with IFRS 15:B40 that is associated with a current revenue contract (whether explicit or implicit because there is a reasonable expectation on the part of a customer that he or she will receive a sales incentive at contract inception); or
(2) a discount that is recognised in the future upon redemption (i.e. when revenue is recognised for the related goods or services) in a manner consistent with IFRS 15:72.

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

- Significant financing component—To assist customers that are experiencing liquidity issues in purchasing goods and services, an entity may provide extended payment terms. Similarly, an entity with liquidity issues may require its customers to make an up-front payment in order for the entity to fulfil its promised goods or services. In those circumstances, an entity should evaluate whether a significant financing component exists in accordance with IFRS 15:60-65. If an entity modifies payments terms for an existing customer contract, it should consider the guidance on price concessions discussed above.
- Implied performance obligations—An entity may assist its customers by providing them with free goods or services that are not explicitly promised in the contract. In a manner consistent with IFRS 15:24, an entity should determine whether its contracts with customers contain promised goods or services that are implied by its customary business practices or published policies or by specific statements that create a reasonable expectation of the customer that the entity will transfer those goods or services.

There may also be instances in which an entity provides free goods or services to its customer that are not part of a prior contract with that customer (i.e. when the prior contract was entered into, there were no explicit or implicit obligations to provide those goods or services).

An entity must carefully evaluate whether the additional promised goods or services are a modification of a pre-existing customer contract or a cost incurred that is separate from any pre-existing contracts. In these situations, it may be helpful to consider the contract combination guidance in IFRS 15:17, which specifies that contracts with the same customer (or related party of the customer) are combined, if (1) they are negotiated as a package with a single commercial objective; (2) the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or (3) there are goods or services in one contract that would be a single performance obligation when combined with the goods or services in another contract.

In addition, an entity should consider the substance of the arrangement to provide the free goods or services and whether accounting for the arrangement as a separate transaction or as a contract modification would faithfully depict the recognition of revenue related to the goods or services promised to the customer in a pre-existing contract. In many cases, free goods or services provided to a customer solely as a result of the COVID-19 pandemic (that are not part of another newly entered contract with that customer) will not be considered a contract modification. However, an entity may need to determine whether it has developed a practice that creates an implied promise in future contracts.

- Recognition of revenue—Because of potential supply disruptions or other circumstances, an entity may need to reconsider the timing of revenue recognition if it is unable to satisfy its performance obligations on a timely basis. In

addition, the entity must determine whether there are any contractual penalties that would affect the transaction price. In some cases, an entity may be completely unable to satisfy its performance obligation, which could result in (1) the termination of the contract, (2) a reversal of any revenue it previously recognised for a performance obligation that was not fully satisfied, and (3) the recognition of a refund liability (or additional liability due to a payment of penalties) instead of deferred revenue.

An entity may also incur unexpected costs in fulfilling a performance obligation that is satisfied over time. If the entity is using costs incurred to date as an input method to measure progress towards complete satisfaction of its performance obligation, it should be careful to ensure that revenue attributed to work carried out is not increased to offset additional costs incurred when abnormal or excessive costs arise as a result of inefficiency or error.

In particular, IFRS 15:B19(a) states that, when using a cost-based input method, entities may be required to adjust the measure of progress when costs are incurred that are "attributable to significant inefficiencies in the entity's performance that were not reflected in the price of the contract".

- Disclosure requirements—Many of the circumstances described above could affect an entity's disclosures. These include, but are not limited to, disclosures of significant changes in the contract asset due to an impairment, significant payment terms (including any significant financing component), and the timing of when an entity expects to recognize revenue for its remaining performance obligations (which would exclude terminated contracts or transactions that do not meet the criteria in IFRS 15:9 to be accounted for as a customer contract).

Given the level of uncertainty caused by the COVID-19 pandemic, an entity may find it challenging to make certain critical estimates. Therefore, it is important for the entity to disclose any significant judgements and estimates it makes in accounting for its revenue contracts (e.g. assessing collectability; estimating and constraining variable consideration; measuring obligations for returns, refunds, and other similar obligations; measuring progress toward completion of a performance obligation recognized over time; and determining the stand-alone selling prices and breakage assumptions for material rights).

6. Restructuring plans

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

i The entity has a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it. If, and only if, both of these criteria are met a restructuring provision should be recognized; and

ii Any part of the business is available for immediate sale in its present condition and completion of such a sale within one year is highly probable. If so, the assets and liabilities to be disposed of are classified as held for sale applying IFRS 5 Non-current Assets Held for Sale and Discontinued Operations and written down to their fair value less costs to sell if this is lower than their carrying amount.

7. Onerous contracts provisions

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

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

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

ii Lease contracts prior to the commencement date.

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

i The cost of fulfilling the contract; and

ii Any compensation or penalties arising from failure to fulfil the contract.

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

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

Provisions should not be recognized in respect to:

Penalties for failure to respect the terms of a revenue contract, such as a late delivery penalty that is incurred if goods are not supplied by a specified delivery date. Such penalties are accounted for under IFRS 15, because they are a form of variable consideration that affects revenue, so they are not within the scope of IAS 37.

Even when a penalty has already been triggered, any associated liability would be accounted for under IFRS 15, and not as a provision under IAS 37 (see Variable Consideration in the Revenue from contracts with customers).

However, if the contract has, as a whole, become onerous as a result of the penalty clause, a provision should be recognized for any net loss expected to result.

Leases (other than short-term leases and leases of low value assets accounted for in accordance with paragraph 6 of IFRS 16 Leases) that become onerous after their commencement date: these leases are dealt with instead applying the general requirements of IFRS 16. For example, an entity will determine and recognize any impairment of ROU assets applying IAS 36. However, an onerous contract provision may need to be recognized for non-lease components that are accounted for separately.

Future operating losses: IAS 37 sets out two prohibitions on the recognition of provisions for future operating losses:

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

8. Insurance recoveries

Entities that incur losses stemming from the COVID-19 pandemic may be entitled to insurance recoveries. For example, losses associated with increased medical claims, asset impairments, or shareholder litigation may be considered insured losses by many entities.

Furthermore, entities may have a business interruption insurance that provides coverage for lost profits due to a suspension of their operations. It may also be the case that an entity with a present obligation can seek reimbursement of part or all of the expenditure from another party, for example via an insurance contract arranged to cover a risk, an indemnity clause in a contract or a warranty provided by a supplier.

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

Note that it is the existence of the reimbursement asset that must be virtually certain, rather than its amount.

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

However, a conclusion that potential insurance recovery is virtually certain will involve significant judgement and should be based on all relevant facts and circumstances. In determining whether the threshold for recognition of a reimbursement asset is met, an entity will most likely, among other factors, need to understand the solvency of the insurance carrier and have had enough dialogue and historical experience with the insurer related to the type of claim in question to assess the likelihood of payment.

Other potential challenges an entity may encounter when evaluating whether a loss is considered recoverable through insurance include, but are not limited to, (1) the need to consider whether losses stemming from a pandemic are specifically excluded as a covered event; (2) the extent of coverage and limits, including multiple layers of insurance from different carriers; and (3) the extent, if any, to which the insurance carrier disputes coverage. Consultation with legal counsel may also be necessary.

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

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

LEASING

9. Lease contracts

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

Impairments to right-of use (ROU) assets could occur as a result of business closures, supply chain disruption, or other consequences of the pandemic that negatively affect the future cash flows expected to be derived from the use of the underlying asset.

ROU assets measured applying a cost model are carried at cost less any accumulated depreciation and any impairment losses (and adjusted for specific remeasurement of the lease liability). Impairment is assessed applying the requirements in IAS 36 discussed above.

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

Generally, the accounting treatment for lease rent concessions will depend on whether (1) the lessee was entitled to the economic relief (i.e. the contractual arrangement or jurisdictional laws provide an enforceable right) or (2) the relief was given or negotiated outside the original agreement.

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

In determining whether the lease contained an entitlement to relief, an entity should consider contractual provisions governing the occurrence of extraordinary events (e.g. a force majeure clause or similar provision). Depending on the complexity of the arrangement and the legal framework in the applicable jurisdiction, the entity may need assistance from legal counsel.

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

Economic stimulus measures put in place to address the financial consequences of the COVID-19 pandemic have led to a lower interest rate environment across many jurisdictions, which may result in bigger lease liabilities having to be recognized following lease modifications.

modified is a finance lease and in IFRS 16:88 if it is an operating lease.

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

Economic stimulus measures put in place to address the financial consequences of the COVID-19 pandemic have led to a lower interest rate environment across many jurisdictions, which may result in bigger lease liabilities having to be recognized following lease modifications.

The impact of the decrease in discount rate will be particularly pronounced for those who on transition to IFRS 16 adopted a full retrospective approach. The current economic conditions are likely to lead to the need to test the ROU asset for impairment and may indeed result in an impairment loss.

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

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

The above discussion addresses relief received from a lessor (either contractually or through negotiation). In some jurisdictions, tenant relief is provided by governments as subsidies in support of the economy. If the lessee receives the relief directly from the government, the tenant relief is accounted for as a government grant applying IAS 20 Accounting for Government Grants and Disclosure of Government Assistance.

If the government relief is provided to the lessor who then passes it to the lessee, careful assessment is needed to establish whether the lessor is acting as an agent and the relief to the lessee is a government grant or whether the relief to the lessee is provided by the lessor and thus is a lease modification.

Effective dates of new and revised Standards and Interpretations

Standard/Interpretation	Date of publication	Effective date (*earlier application permitted)
IFRS 16 Leases	January 2016	1 January 2019*
Plan Amendment, Curtailment or Settlement (Amendments to IAS 19)	07 Feb 2018	1 January 2019
IFRS 17 Insurance Contracts	May 2017	1 January 2022*2
Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts Amendments to IFRS 4		1 January 2018*
September 2016	1 January 2018*	1 January 2018*
Classification and Measurement of Share-based Payment Transactions Amendments to IFRS 2		1 January 2016*
June 2016	1 January 2018*	1 January 2017*
Disclosure Initiative (Amendments to IAS 1)	December 2014	1 January 2017*
Disclosure Initiative (Amendments to IAS 7)	January 2016	1 January 2017*
Recognition of Deferred Tax Asset for Unrealised Losses (Amendments to IAS 12)	January 2016	1 January 2016*
Amendments to International Financial Reporting Standard for Small and Medium Sized Entities (IFRS for SMEs)	September 2015	1 January 2016*
Investment Entities: Applying the Consolidation Exception (Amendments to IFRS 10, IFRS 12 and IAS 28)	December 2014	1 January 2016*
Annual Improvements to IFRSs 2012–2014 Cycle	September 2014	1 January 2016*
Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28)	September 2014	1 January 2018*
Equity Method in Separate Financial Statements (Amendments to IAS 27)	August 2014	1 January 2016*
IFRS 9 Financial Instruments	July 2014	1 January 2018*
Agriculture: Bearer Plants (Amendments to IAS 16 and IAS 41)	June 2014	1 January 2016*
IFRS 15 Revenue from Contracts with Customers (including clarifications to IFRS 15 published in April 2016)	May 2014	1 January 2016*
Clarification of Acceptable Methods of Depreciation and Amortisation (Amendments to IAS 16 and IAS 38)	May 2014	1 January 2016*
Accounting for Acquisitions of Interests in Joint Operations (Amendments to IFRS 11)	May 2014	1 January 2016*
IFRS 14 Regulatory Deferral Accounts	January 2014	1 January 2016*

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