Applying IFRS

Accounting considerations of the coronavirus outbreak

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EY

Building a better working world

Contents

1. Background

As the outbreak continues to evolve, it is difficult, at this juncture, to estimate the full extent and duration of the business and economic impact. Consequently, these circumstances have presented entities with greater challenges when preparing their interim and annual IFRS financial statements.

The threats posed by the coronavirus outbreak are not stopping. More countries have imposed travel bans on millions of people and more people in more locations are placed with quarantine measures. Businesses are dealing with lost revenue and disrupted supply chains. The disruption to global supply chains due to factory shutdowns has already exposed the vulnerabilities of many organisations. The outbreak has also resulted in significant volatility in the financial and commodities markets worldwide. There are already signs that the virus has significantly impacted the world economy. Various governments have announced measures to provide both financial and non-financial assistance to the disrupted industry sectors and the affected business organisations.

In February, we issued *Applying IFRS accounting considerations of Coronavirus outbreak,* which focuses on addressing the financial effects when preparing IFRS financial statements for the year ended 31 December 2019. The new circumstances described above have presented entities with greater challenges in preparing their IFRS financial statements.

This publication, therefore, provides a reminder of the existing accounting requirements that should be considered when addressing the financial effects of the coronavirus outbreak in the preparation of IFRS financial statements for the annual or interim reporting periods ending in 2020. Disclosure considerations for interim financial reporting are also covered in this publication. The issues discussed are by no means exhaustive and their applicability depends on the facts and circumstances of each entity. The financial reporting issues, reminders and considerations highlighted in this publication are the following:

- Going concern
- Financial instruments
- Assets impairment
- Government grants
- Income taxes
- Liabilities from insurance contracts
- Leases
- Insurance recoveries
- Onerous contract provisions
- Fair value measurement
- Revenue recognition
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2. Going concern

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

The going concern assessment needs to be performed up to the date on which the financial statements are issued.

In assessing whether the going concern assumption is appropriate, the standard requires that all available information about the future, which is at least, but not limited to, twelve months from the end of the reporting period, should be taken into account. This assessment needs to be performed up to the date on which the financial statements are issued. Refer to section 3 for further discussion on the current vulnerability entities are facing due to concentration and liquidity risks.

Measurement

Management is required to assess the entity's ability to continue as a going concern. When making that assessment, where relevant, management takes into consideration the existing and anticipated effects of the outbreak on the entity's activities in its assessment of the appropriateness of the use of the going concern basis. For example, when an entity has a history of profitable operations and relies on external financing resources, but because of the outbreak, its operations have been suspended before or after the reporting date, management would need to consider a wide range of factors relating to the current adverse situation including, expected impact on liquidity and profitability before it can satisfy itself that the going concern basis is appropriate. Management should consider all available information about the future which was obtained after the reporting date including measures taken by governments and banks to provide relief to affected entities in their assessment of going concern.

Disclosure

Given the unpredictability of the potential impact of the outbreak, there may be material uncertainties that cast significant doubt on the entity's ability to operate under the going-concern basis. If the entity, nevertheless, prepares the financial statements under the going-concern assumption, it is required to disclose these material uncertainties in the financial statements in order to make clear to readers that the going-concern assumption used by management is subject to such material uncertainties.

How we see it

The degree of consideration required, the conclusion reached, and the required level of disclosure will depend on the facts and circumstances in each case, because not all entities will be affected in the same manner and to the same extent. Significant judgement and continual updates to the assessments up to the date of issuance of the financial statements may be required given the evolving nature of the outbreak and the uncertainties involved.

3. Financial instruments

While coronavirus continues to spread, the world is undergoing massive adjustments reacting to this outbreak. Though the outcome is unpredictable, and the conditions are still fluid and volatile, these adjustments (or measures) may or may not have a direct impact on the accounting for financial instruments. IFRS 9 *Financial Instruments* and IFRS 7 *Financial instruments: Disclosures* deal with the accounting for financial instruments and the related disclosures. Entities should exercise careful considerations for the proper accounting. Additional accounting considerations for banks are also included in this section.

Current vulnerability due to concentration and liquidity risks

Entities with concentrations of risk face greater risk of loss than other entities. Paragraph 34(c) of IFRS 7 requires that concentration of risk should be disclosed if not otherwise apparent from other risk disclosures provided. Therefore, entities should consider including the following information:

- A description of how management determines concentrations of risk
- A description of the shared characteristic that identifies each concentration (e.g., counterparty, geographical area, currency or market). For instance, the shared characteristic may refer to geographical distribution of counterparties by groups of countries, individual countries or regions within countries and/or by industry
- The amount of the risk exposure associated with all financial instruments sharing that characteristic

Entities that have identified concentrations of activities in areas or industries affected by the outbreak (such as, e.g., the airline, hospitality and tourism industries) that have not previously disclosed the concentration because they did not believe that the entity was vulnerable to the risk of a near-term severe impact, should now reconsider making such a disclosure.

Similarly, liquidity risk in the current economic environment is increased. Therefore, it expected that the disclosures required under IFRS 7 in this area will reflect any changes in the liquidity position as result of the coronavirus outbreak.

Similarly, liquidity risk in the current economic environment is increased. Therefore, it is expected that the disclosures required under IFRS 7 in this area will reflect any changes in the liquidity position as a result of the coronavirus outbreak. Entities should be mindful that this disclosure is consistent with their assessment of the going concern assumption.

For entities that will prepare interim financial statements under IAS 34 *Interim Financial Reporting*, if concentration and liquidity risks have significantly changed compared to their most recent annual financial report, they should disclose the above information in their interim financial statements.

Asset classification and business model assessment: impact of sales

A deterioration of the credit quality of the borrower or the issuer of a financial asset, as a result of the coronavirus outbreak, may result in entities deciding to dispose of investments classified as 'hold-to-collect' under IFRS 9. As a reminder, if the sale is due to an increase in credit risk, this would be consistent with the business model objective 'hold to collect', because the credit quality of financial assets is relevant to the entity's ability to collect contractual cash flows. Selling a financial asset because it no longer meets the credit criteria specified in the entity's documented investment policy is an example of a sale that would be consistent with the business model 'hold to collect'.

Additionally, an increase in the frequency and value of sales in a particular period is not necessarily inconsistent with an objective to hold financial assets in order to collect contractual cash flows, if an entity can explain the reasons for those sales and demonstrate why sales in future will be lower in frequency or value. For example, if, due to a significant decrease in demand for the entity's products or services as a result of the pandemic (e.g., airline tickets or hospitality events) the entity faces a temporary liquidity crisis, a sale of financial assets classified as held-to-collect may not be inconsistent with such business model.

As a reminder, reclassifications triggered by a change in the business model for managing financial assets are expected to be very infrequent and will occur only when an entity either begins or ceases to perform an activity that is significant to its operations (for example, acquisition, disposal or termination of a business line). A change in intention related to particular financial assets (even in circumstances of significant changes in market conditions) is not a change in business model.

Contract modifications

Affected entities may experience cash flow challenges as a result of disruptions in their operations, higher operating costs or lost revenues. Such entities may need to obtain additional financing, amend the terms of existing debt agreements or obtain waivers if they no longer satisfy debt covenants. In such a case, they will need to consider the guidance provided in IFRS 9 to determine whether any changes to existing contractual arrangements represent a substantial modification or potentially a contract extinguishment, which would have accounting implications in each case.

For financial liabilities, in summary, an entity should derecognise the liability if the cash flows are extinguished (i.e., when the obligation specified in the contract is discharged, cancelled or expires) or if the terms of the instrument have substantially changed.

IFRS 9 provides guidance on determining if a modification of a financial liability is substantial, which includes a comparison of the cash flows before and after the modification, discounted at the original effective interest rate (EIR), commonly referred to as 'the 10% test'. If the difference between these discounted cash flows is more than 10%, the instrument is derecognised. However, other qualitative factors could lead to derecognition irrespective of the test (e.g., if a debt is restructured to include an embedded equity instrument).

For financial assets, there is no explicit guidance in IFRS 9 for when a modification should result in derecognition. Hence, we see entities applying their own accounting policies, which are often based on qualitative considerations and, in some cases, include the '10% test'. However, the IFRS Interpretations Committee has indicated that applying the '10% test' in isolation would not always be appropriate, because of potential inconsistencies with the impairment requirements in IFRS 9. We observe some preparers applying different accounting policies depending on whether a modification is granted due to financial difficulty of the borrower, with some concluding that such circumstance would more rarely result in the derecognition of the financial asset.

If, following the guidance above, a modified financial asset or liability does not result in derecognition, the original EIR is retained and there is a catch-up adjustment to profit or loss for the changes in expected cash flows discounted at the original EIR. For floating rate instruments, a change in the market rate of interest is accounted for prospectively. However, any other contractual change (e.g., the spread applied above the interest rate) would also result in a catch-up adjustment at the date of modification.

Hedge accounting

Business transactions may be postponed or cancelled, or they may occur in significantly lower volumes than initially forecasted. If an entity has designated a transaction such as the purchase or sale of goods or the expected issuance of debt, as a hedged forecasted transaction in a cash flow hedge accounted for under IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9, the entity will need to consider whether the transaction is still a 'highly probable forecasted transaction'. This includes whether the volume or amounts involved will be lower than forecasted or whether it is now no longer probable that the forecasted transaction will occur.

That is, if the coronavirus outbreak affects the probability of hedged forecasted transactions occurring during the time period designated at the inception of a hedge, an entity will need to determine whether it can still apply hedge accounting to the forecasted transaction or a proportion of it:

- If an entity determines that a forecasted transaction is no longer highly probable, but still expected to occur, the entity must discontinue hedge accounting prospectively.[1] In this case, the accumulated gain or loss on the hedging instrument that has been recognised in other comprehensive income will remain recognised separately in equity until the forecasted transaction occurs.
- If an entity determines that a forecasted transaction is no longer expected to occur, in addition to discontinuing hedge accounting prospectively, it has to immediately reclassify to profit or loss any accumulated gain or loss on the hedging instrument that has been recognised in other comprehensive income.

Impairment consideration of equity instruments classified as available for sale by insurance companies

Although IFRS 9 replaced IAS 39 there are many insurance companies who still apply IAS 39 as allowed by IFRS 4. This means that there are different classification and measurement rules and different impairment rules than those described above. For equity instruments classified as available for sale this means that a significant or prolonged decline in fair value is objective evidence of impairment and the negative amount recognised in other comprehensive income for such equity instrument should be recycled to profit or loss. The determination of what is 'significant or prolonged' requires judgement. The basis for what is considered 'significant or prolonged' must be applied consistently from period to period. Insurance companies applying IAS 39 should

[1] As a reminder, a reduction in the designated quantity of the hedged item because some cash flows are no longer highly probable is not included in the IFRS 9 concept of 'rebalancing', which otherwise allows adjusting the designated quantities of hedged items to allow keeping hedge effectiveness.

The measurement of ECL should be based on an unbiased, probability-weighted amount that is determined by evaluating a range of possible outcomes and reflecting time value of money

consider the volatile financial markets and determinewhether any available for sale equity instruments they may have are impaired.

Expected credit loss (ECL) assessment

The occurrence of large scale business disruptions that potentially gives rise to liquidity issues for certain entities might also have consequential impacts on the credit quality of entities along the supply chain. This will also have knock on effects on retail portfolios (consumer and mortgage loans) as many businesses will have to reduce staff numbers resulting in a sharp increase in numbers of unemployed workers. The deterioration in credit quality of loan portfolios, but also, e.g., of trade receivables, as a result of the outbreak will have a significant impact on the ECL measurement. In responding to these challenges, certain governments and central banks have introduced, or have directed or encouraged commercial banks to introduce, various types of relief measures to corporates, small and medium-sized enterprises or mortgage borrowers.

The measurement of ECL should be based on an unbiased, probability-weighted amount that is determined by evaluating a range of possible outcomes and reflecting time value of money. Entities should exercise judgement and their best efforts to consider all reasonable and supportable information available about past events, current conditions and forecasts of future economic conditions, as described further in this publication. Given the unprecedented circumstances, it will be critical that entities provide transparent disclosure of the assumptions used to measure the ECL and provide sensitivity disclosures.

Re-segmentation of loan portfolios or groups or receivables

For the purpose of measuring ECLs and for determining whether significant increase in credit risk (SICR) has occurred, an entity should group financial instruments on the basis of shared credit risk characteristics and reasonable and supportable information available on a portfolio basis.

The occurrence of the coronavirus outbreak might change the risk characteristics of certain loans or receivables, because the respective borrowers or customers might engage in businesses, or locate in areas, which have become affected, or are more prone to be affected, by the outbreak. Therefore, entities should consider (re)segmenting (sub)portfolios.

Individual and collective assessment of loans, receivables and contract assets

Due to the abnormal circumstances, it may take time for an entity to detect actual changes in risk indicators for a specific counterparty. In order to accelerate the reflection of such changes in credit quality not yet detected at an individual level, it may be appropriate to adjust ratings and the probabilities of default (PD) on a collective basis, considering risk characteristics such as the industry or geographical location of the borrowers. For example, a supplier of products or services to the airline industry would likely consider that the PD of its customers has increased irrespective of specific events identified at the level of individual counterparties. In estimating PD and ECL, entities should consider the effect of any state aid plans to support customers through various measures (e.g. refinancing measures or other forms of financial support, including guarantees). Additionally, entities who are using multiple economic scenarios when estimating ECL should consider updating these scenarios to reflect the current change in circumstances (for further guidance, refer to the section 'Additional considerations on ECL for banks' of this document).

Extension of payment terms

If payment terms are extended in light of the current economic circumstances, the terms and conditions of the extension will have to be assessed to determine their impacts on the ECL estimate as well as any other accounting impacts. For example, if the payment terms of a receivable are extended from 90 days to 180 days, this would likely not be considered a substantial modification of the receivable. However, such extension is expected to result in an increase in PD, which would, in turn, affect the measurement of ECL. For entities which do not apply the simplified model, such extension may result in moving into stage 2, depending on the extent and detailed terms of the payment extension.

Additional considerations on ECL for banks

Forbearance and other relief measures granted to borrowers

The accounting impact of forbearance and relief measures on ECL depends on the details of the arrangements. Some relief measures (for example, an extension of repayment term for 3 or 6 months) might be available country-wide and automatically applied to all borrowers, regardless of their credit standing. In that case, the deferral of repayment may not necessarily indicate per se a significant increase in credit risk (SICR) as it is offered irrespectively of the condition of each applicant, and an assessment of the borrower's individual circumstances is, therefore, needed to determine whether there has been a SICR. However, if the measure is offered to everyone, but a borrower must apply to benefit from it, then the fact that an application is made may be an indication of SICR, as it suggests that the borrower needs the relief to comply with its contractual obligations. Additionally, offering a relief measure of such magnitude to all borrowers in an economic environment indicates a significant adverse change in the economic environment of the borrower, which is one of the indicators included in paragraph B5.5.17 of IFRS 9 that should be considered for the assessment of SICR.

If payment terms are extended in the light of the current economic circumstances, the terms and conditions of the extension will have to be assessed to determine their impacts on the ECL estimate.

In another situation, if the relief measures are available only to those who meet certain criteria, entities need to carefully assess whether such criteria themselves might indicate a significant increase in credit risk for all affected borrowers. For instance, a significant increase in credit risk is likely to have occurred if a borrower applies for a relief measure which is available only to corporates which have suspended operations or individuals who have lost employment. Another example is if the relief, such as a deferral of loan payments, is offered to all participants in certain industries (e.g., entities engaging in the hospitality and travel businesses). This circumstance may indicate that borrowers in that industry are exposed to a higher risk of business failure and thus a higher probability of default as a class. In combination with other reasonable and supportable information, this is likely to result in the classification of the related loans and other exposures in this portfolio, or a portion of them, into stage 2. The assessment should be made irrespective of the fact that a concession is imposed by laws or regulations. Entities are also expected to exercise judgement, in light of all facts and circumstances, to determine if the respective loans are credit impaired and should therefore be classified as stage 3.

The above discussion assumes that the forbearance measures allow a deferral of principal payment(s), but interests would continue to accrue, whereas some other measures might give rise to a loan restructuring, with a loss of principal or interest by the lenders, which would likely result in a classification as stage 3, rather than stage 2. The ECL allowance would reflect the lifetime ECL in both cases, but with a probability of default of 100% for credit-impaired loans.

These measures may have an impact on risk management policies for monitoring and reporting credit events as well as how banks manage client relationships and late payments. Entities will need to assess how these changes relate to their definition of default. In any case, they will need to consider that historical information available to estimate ECL (in particular, loss given default) may not be representative of the current circumstances arising from the impacts of a pandemic outbreak.

Entities should monitor whether further guidance will be issued by standard setters for dealing with the accounting and disclosure of relief measures under these exceptional circumstances, as well as any additional disclosure guidance provided by regulators or industry bodies.

Individual and collective assessment, multiple macroeconomic scenarios and management overlays

Whether the impact of the outbreak is reflected in an individual assessment (e.g., estimation of probability of default on an individual basis), factored into the scenario analysis of future macroeconomic conditions on a collective basis, or adjusted through management overlays, depends on the facts and circumstances. In practice, entities may probably consider a combination of these approaches.

Due to the abnormal circumstances, it may take time before banks detect changes in risk indicators at a specific borrower level and are able to reassess the affected exposures. In order to accelerate the reflection of such changes in credit quality not yet detected at an individual level, it may be appropriate to adjust ratings and the probabilities of default on a collective basis, considering risk characteristics such as the industry or geographical location of the borrowers. This would result in ECL adjustments as well as the identification of SICR triggers for some exposures.

Many financial institutions consider multiple macroeconomic scenarios in the assessment of ECL. The current situation is not likely to have been reflected in any of the scenarios used for the ECL estimates at the prior year end and, as such, will need to be updated . In addition to updating GDP expectations for the various scenarios, a challenge will be to estimate how the impact of the coronavirus outbreak will affect specific sectors, regions and borrowers. Also, the relationship between GDP and other macroeconomic variables, such as unemployment and interest rates, and sector-specific variables, such as the oil prices is very likely to be different from what has been experienced in the past and is currently used in economic forecasting models. The probability weightings assigned to macroeconomic scenarios may also need to be revisited.

Additionally, it may be appropriate to consider the use of top-down 'management overlays', to embed in the ECL risks not yet fully captured by the models. In estimating overlays, entities may consider historical experience, including, for instance, the impact of similar events such as the SARS outbreak in 2003. However, it appears clear that the widespread nature and severity of the consequences of the coronavirus outbreak is not directly comparable with any recent similar events. It may be appropriate for this purpose, to plot several possible scenarios of what might happen over the next six months and assign weightings to them, to ensure that any overlay reflects the inherent uncertainty and non-linearity of potential outcomes.

In estimating the impact of coronavirus outbreak, entities should, nevertheless, avoid double-counting of the effects of various assumptions applied in individual assessment, macroeconomic scenarios and management overlays.

Impacts on EAD and LGD

The effect of credit enhancements on the loss given default (LGD) for both individual and collective assessments will have to be taken into account, considering the impact of the outbreak on the values of collaterals and guarantees (e.g., shares or bonds prices, real-estate values and the credit standing of any guarantor). Additionally, certain forms of government assistance to compensate entities for losses suffered directly or indirectly due to the coronavirus outbreak may be triggered in some jurisdictions. In such a case, an analysis of the specific facts and circumstances may be required to establish whether these initiatives should be accounted for as guarantees integral to the loan, and therefore, affect the LGD estimate, or should be recognised as a separate reimbursement asset or a government grant under IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*.

The estimate of the exposure at default (EAD) will also have to be updated, especially for loan commitments and other types of credit facilities (e.g., revolving credit facilities such as overdrafts on current accounts and credit cards), where a deterioration of the macroeconomic environment is generally accompanied by an increase in the volumes and duration of drawdowns.

Disclosures

Given the inherent level of uncertainty and the sensitivity of judgements and estimates, disclosures of the key assumptions used and judgements made in estimating ECL are particularly important. This is especially the case as they will have likely been materially updated compared to the key assumptions, judgements and estimates applied in the latest annual financial statements. These would include, for example, the values of the key macroeconomic inputs used in the multiple economic scenario analysis and the probability weights of these scenarios, as well as the assumptions used to determine how the different challenges for specific sectors and regions have been taken into account and the effect of any management overlays.

Additionally, entities should provide disclosures to allow users of financial statements to understand the nature of any material reliefs offered to their borrowers, including those enforced by governments, and how they have assessed whether they constitute forbearance, whether they result in a substantial modification of the contract, their effect on staging and the impact on the overall ECL.

How we see it

The assessment of the impact of the coronavirus outbreak on ECL will require significant judgement, especially as it is not directly comparable with any recent similar events. Entities will have to update their macroeconomic scenarios and consider the use of top-down ‘management overlays’ to embed in the ECL risks not yet fully captured by their models. Given the level of uncertainty and the sensitivity of judgements and estimates, disclosures of the key assumptions used and judgements made in estimating ECL, as well as the impact of any relief measures, is going to be critical.

4. Impairment assessment

An asset is impaired when an entity is not able to recover its carrying value, either by using it or selling it. An entity estimates the recoverable amount of the asset for impairment testing. Recoverable amount is the higher of the fair value less costs of disposal (FVLCD) and the value in use (VIU). Value in use is defined as the present value of the future cash flows expected to be derived from an asset or cash generating unit. The calculation of an asset's value in use incorporates an estimate of expected future cash flows and expectations about possible variations of such cash flows.

IAS 36 *Impairment of Assets* requires an entity to assess, at the end of each reporting period, whether there is any impairment for an entity's non-financial assets. For goodwill and intangible assets with indefinite useful lives, the standard requires an annual impairment test and when indicators of impairment exist. For other classes of assets within the scope of the standard, an entity is required to assess at each reporting date whether there are any indications of impairment. The impairment test only has to be carried out if there are such indications.

Events after the reporting period and information received after the reporting period should be considered in the impairment indicator assessment only if they provide additional evidence of conditions that existed at the end of the reporting period. Similarly, the determination of the recoverable amounts of an asset should only consider the information obtained after the reporting date if such information relates to conditions existing as of the reporting period end. Judgement of all facts and circumstances is required to make this assessment.

Existence of impairment indicators

As mentioned above, an entity is required to assess at the reporting date whether there are any indicators of impairment. With the recent developments of the outbreak, there are both external and internal sources of information, such as the fall of stock and commodity prices, decrease of market interest rates, manufacturing plant shutdowns, shop closures, reduced demand and selling prices for goods and services, etc, indicating an asset may be impaired.

Measurement

When estimating the recoverable amount based on the value in use, the forecasted cash flows should reflect management's best estimate of the economic conditions that will exist over the remaining useful life of the asset.

When assessing impairment, entities are required to determine the recoverable amounts of the assets. FVLCD is the fair value as defined in IFRS 13 which has been explained in section 11 *Fair value measurement* in this publication. The estimation of the VIU involves estimating the future cash inflows and outflows that will be derived from the use of the asset and from its ultimate disposal and discounting the cash flows at an appropriate rate.

In cases where the recoverable amount is estimated based on value in use, the considerations on accounting estimates apply. The forecasted cash flows should reflect management's best estimate at the end of the reporting period of the economic conditions that will exist over the remaining useful life of the asset. With the current uncertain situation, significant challenges are expected to prepare the forecast of or budgets for future cash flows. In these circumstances, an expected cash-flow approach based on probability-weighted scenarios may be more appropriate to reflect the current uncertainty than a single best estimate when estimating value in use.

Since the remaining useful life for many assets, such as goodwill, is long term, entities should consider not just the short term effects, but especially the long term effects.

Disclosure

The more the current environment is uncertain, the more important it is for the entity to provide detailed disclosure of the assumptions taken, the evidence they are based on and the impact of a change in the key assumptions (sensitivity analysis).

Given the inherent level of uncertainty and the sensitivity of judgements and estimates, disclosures of the key assumptions used and judgements made in estimating recoverable amount will be particularly important. This is especially the case as they will have likely been materially updated compared to the key assumptions, judgements and estimates applied in the latest annual financial statements. These would include, for example, the values of the key assumptions and the probability weights of multiple scenarios when using an expected outcome approach

How we see it

As the crisis evolves and the conditions are unpredictable, at this stage, management is required to exercise significant judgement to assert reasonable assumptions which reflect the conditions existing at the reporting date for impairment testing. We expect that in the current situation, majority of these assumptions are subject to significant uncertainties. As such, entities should consider providing detailed disclosures on the assumptions and sensitivities.

5. Government grants

Requirements

IAS 20 *Accounting for Government Grants and Disclosures of Government Assistance* applies to the accounting for, and the disclosure of, government grants and to the disclosure of other forms of government assistance. The distinction between government grants and other forms of government assistance is important because the standard's accounting requirements only apply to the former. Government grants are transfers of resources to an entity in return for past or future compliance with certain conditions relating to the entity's operating activities. The purpose of government grants, which may be called subsidies, subventions or premiums, and other forms of government assistance is often to encourage a private sector entity to take a course of action that it would not normally have taken if the assistance had not been provided.

SIC-10 *Grants with no specific relation to operating activities* addresses the situation in some countries where government assistance is provided to entities, but without any conditions specifically relating to their operating activities, other than to operate in certain regions or industry sectors.

Scope

Due to the severe impact on many entities' business activities of the coronavirus outbreak, many countries' governments, agents or similar bodies have introduced (or are expected to introduce) relevant measures to assist entities. However, not all of these measures are considered as government grants. Entities should evaluate the measures carefully and determine which standards should govern the respective accounting treatment.

Recently many countries' governments, agents or similar bodies have introduced (or are expected to introduce) relevant measures to assist entities in response to the coronavirus. These measures include direct subsidies, tax exemptions, tax reductions and credits, extended expiry period of unused tax losses, reduction of public levies, rental reductions or deferrals and low-interest loans.

Whilst the benefit of a low-interest loan would be accounted for under IFRS 9 and IAS 20, not all these measures are accounted for as government grants. For example, a reduction of income tax is accounted for under IAS 12 *Income Taxes*; and rental reductions or deferrals may be accounted for under IFRS 16 *Leases*. Accordingly, entities should analyse all facts and circumstances carefully to apply the appropriate relevant accounting standards. We will focus on the accounting for government grants under IAS 20 in this section and will have more detailed analysis in other sections to discuss the accounting for those measures which are governed by accounting standards other than IAS 20.

Recognition in the statement of financial position

Government grants should be recognised as an asset only when there is reasonable assurance that the entity will comply with the conditions attaching to them and the grants will be received. For example, when the government has decided to give out special subsidies to the affected entities, government grants can be recognised only when it is confirmed that an entity is eligible to receive the subsidy and that any conditions attaching to these subsidies are met. In cases where subsidies relating to coronavirus outbreak are given to entities without any specified conditions, an asset can be recognised at the time when it is reasonably certain that the grants will be received. Nevertheless, it is important to note that the receipt of a grant does not of itself provide conclusive evidence that the conditions attaching to the grant have been, or will be, fulfilled.

Recognition in the income statement

Government grants must be recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate. In cases where a grant relates to expenses or losses already incurred, or for the purpose of giving immediate financial support to the entity with no future related costs expected to be incurred, the grant should be recognised in income when it becomes receivable.

Government may decide to stimulate economic activity by providing subsidies on investments by entities. If these subsidies are related to investment in assets which will be used by the entities over a longer term, the grant should be recognised in profit or loss over the useful lives of those related acquired assets.

Measurement

Direct cash assistance or subsidies will be measured at their fair value. However, government grants can take other forms. For example, when a government grant takes the form of a low-interest government loan, the loan should be recognised and measured in accordance with IFRS 9 (at its fair value) and the difference between this initial carrying value of the loan and the proceeds received is treated as a government grant. A forgivable loan from government, the repayment of which will be waived under certain prescribed conditions, is initially accounted for as a financial liability under IFRS 9 and would only be treated as a government grant when there is reasonable assurance that the entity will meet the terms for forgiveness. When government grants take the form of a transfer of non-monetary assets, such as plant and equipment, for the use of the entity, entities may apply an accounting policy choice to account for such grants at fair value of the non-monetary assets or at a nominal amount

Presentation

Grants that are related to assets should be presented in the statement of financial position either by setting up the grant as deferred income, which is presented as income over the useful life of the asset; or by deducting the grant in arriving at the carrying amount of the asset, in which case, the benefit is presented in profit or loss as a reduction to depreciation.

Grants related to income should be presented either as a credit in the income statement, either separately or under a general heading such as ‘other income’, or as a deduction in reporting the related expense.

Disclosure

IAS 20 requires entities to disclose the following information:

- The accounting policy adopted for government grants, including methods of presentation adopted in the financial statements
- 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
- Unfulfilled conditions and other contingencies attaching to government assistance that has been recognised

How we see it

Whether IAS 20 should be applied depends on the facts and circumstances of the specific measures implemented by the government, including government agencies and similar bodies. Entities need to analyse all facts and circumstances carefully to determine the appropriate accounting treatment.

6. Income taxes

Recent government responses to the coronavirus outbreak have included income tax concessions and other rebates. Entities need to consider the impacts of these legislative changes on their accounting for income taxes.

Requirements

A range of economic stimulus packages have been announced by governments around the world. Recent government responses to the coronavirus outbreak have included income tax concessions and other rebates. Entities need to consider the impacts of these legislative changes on their accounting for income taxes. IAS 12 *Income Taxes* requires current tax liabilities and assets for current and prior periods to be measured at the amount expected to be paid to (or recovered from) the taxation authority, using the tax rates and laws that were enacted, or substantively enacted, by the end of the reporting period. Deferred tax assets and liabilities must be measured at the tax rates expected to apply to the period when the asset is realised or the liability is settled, also using the tax rates and laws that were enacted, or substantively enacted, by the end of the reporting period.

IFRIC 23 *Uncertainty over Income Tax Treatments* requires an entity to consider whether it is probable that a taxation authority will accept an uncertain tax treatment. If the entity concludes that the position is not probable of being accepted, the effect of the uncertainty needs to be reflected in the entity's accounting for income taxes.

Substantively enacted or not

In some jurisdictions, announcements of tax rates (and tax laws) by the government have the substantive effect of actual enactment. In such circumstances, tax assets and liabilities are measured using the announced tax rate. However, this is not always the case and an entity would need to consider when the tax concessions (e.g., reduced tax rates) become substantively enacted in their jurisdiction, for example, by considering the legislative process and consensus in its jurisdiction for when a law becomes substantively enacted.

Recognition

Conditions attached to tax relief

Some governments might structure their tax relief so it applies only to entities who have been impacted by the coronavirus outbreak based on certain qualifying criteria, for example, only entities in certain sectors, or entities of a certain size (e.g., by revenue), or that have suffered a certain amount of economic impact. This may give rise to uncertainty and the need for entities to make judgements and estimates when assessing their income tax position, for example, whether for that taxation period, the entity will fall below the revenue threshold in order to receive the tax concession. Entities will need to determine whether it is probable that the taxation authority will accept their position. If not, IFRIC 23 requires entities to assess whether to recognise any additional liability for uncertain tax positions. The same requirement applies to recognition of uncertain tax assets.

Tax credits

Tax relief may come in the form of tax credits. Tax credits are not defined within IFRS, and entities need to exercise judgement in determining how the receipt of a tax credit should be accounted for, as a reduction in tax liability under IAS 12, or the receipt of a government grant under IAS 20, when it is structured as a cash payment or has other indicators of a grant such as non-tax related conditions being attached to it (for example, cash spend on approved research and development related activities). A tax credit to be treated in accordance with IAS 12 will have indicators such as reducing income taxes payable (being forfeited or deferred if there are insufficient taxes payable) and having few, if any, non-tax conditions attached to it. A tax credit to be treated in accordance with IAS 20 will often be directly settled in cash in the case of insufficient taxes payable and have non-tax conditions attached. In any case, all facts and circumstances relating to the specific relief need to be considered in assessing the substance of the arrangement.

Measurement

Current and deferred tax balances

Many governments announced tax stimulus packages in early 2020. This would not impact the measurement of current tax balances and deferred tax balances as at 31 December 2019. Some tax concessions such as tax rate reductions could relate to prior years. Because IAS 12 states that these balances are to be measured in accordance with the rates and laws that had already been substantively enacted as at reporting date, any impacts relating to prior taxation years would only be recorded in the financial period in which the amending legislation was substantively enacted.

Entities with reporting periods ended or ending in 2020 need to consider if the tax concessions announced in early 2020 are substantively enacted prior to reporting period end. As noted earlier, entities need to consider what is generally understood as 'substantively enacted' in their own jurisdiction. If determined to be substantively enacted by reporting date, then current tax balances and deferred tax balances would be measured based on the tax incentives including reduced tax rates under the stimulus package.

In cases where the tax concessions are staggered over several years, such as incremental tax rate reductions, the expected timing of the reversal of deferred tax balances will also need to be assessed.

Carry forward of tax losses

In assessing the probability of the future realisation of carry forward tax losses, entities will need to consider whether the adverse economic conditions arising as a result of the coronavirus outbreak existed as at reporting date. If so, the entity will need to consider the deterioration of the economic outlook in its forecasts of taxable profits and reversals of taxable temporary differences. If not, the event is non-adjusting, but the entity should consider disclosure around the nature of the subsequent event.

Disclosure

In addition to subsequent event disclosures, the following will also be relevant for entities impacted by the coronavirus outbreak: an explanation of changes in the applicable tax rate compared to the prior period; the amount and expiry date of any carry forward tax losses; and the nature of evidence supporting the recognition of deferred tax assets when the entity has suffered a loss in the current period. The entity should also consider disclosure of the nature of any significant judgements or estimates made when determining the appropriate accounting for the matters described above. Such judgements may include whether the tax laws were substantively enacted as of reporting date, and the determination of the accounting for income tax credits.

How we see it

Entities need to determine whether changes to tax rates and laws as part of government responses to the coronavirus outbreak, were substantively enacted as of the reporting date. The characteristics of any tax relief or rebates received by the government need to be carefully assessed in order to determine whether they should be accounted for as a reduction to the income tax expense, or the receipt of a government grant. Uncertainties relating to income taxes arising from these new government measures will require entities to consider whether they should recognise and measure current and/or deferred tax assets or liabilities at a different amount.

7. Liabilities from insurance contracts

IFRS 4 *Insurance Contracts* requires an entity issuing insurance contracts to account for its rights and obligations from the insurance contracts it issues. The current coronavirus outbreak situation could affect an entity's liabilities for issued insurance contracts for a range of product lines. For example, entities issuing life or health products may be faced with claims caused by the impact of the outbreak on policyholders' health status. Entities may also be affected by claims where cover is provided for events driven by the disruption caused by the outbreak, for example, business interruption insurance, event cancellation insurance, travel insurance and credit insurance. However, since coronavirus is a new disease, contractual terms may not be clear on whether policyholders can claim against the insurer. Also, entities need to consider any interpretations, directives or rulings by local authorities (e.g., government, regulator or health agency) that could impact the obligations under the contract for the entity.

Measurement

Entities issuing insurance contracts will therefore need to assess the impact the coronavirus, or the disruption caused by the outbreak, to their insurance liabilities based on their specific accounting policies, including the effect on the liability adequacy testing of the insurance liabilities.

Entities issuing insurance contracts will therefore need to assess the impact of the coronavirus, or the disruption caused by it, on their insurance liabilities based on their specific accounting policies. This includes the effect on the liability adequacy testing of the insurance liabilities. This assessment would need to consider factors including, but not limited to, the effect on reported claims, the effect on incurred but not (enough) reported claims, the impact of these effects on the assumptions for estimating expected future claims, and the impact on the entity's claims handling expenses. Where the entity reinsured risk from its insurance contracts, it should also consider the associated recovery through its asset from reinsurance contracts held.[2] In determining these effects, the entity should consider not only the terms and conditions of its insurance contracts, but also the implications of any interpretations, directives or rulings by local authorities for those terms and conditions (see above). Where an entity's accounting policies for the measurement of its insurance liabilities may also involve the use of current estimates of market variables, for example, interest rates and equity prices, the entity should reflect the impact of market developments on these variables in its measurement.

Entities should also assess whether the coronavirus gives rise to events after the reporting period and determine the implications for the financial statements. As the pandemic continues to evolve, situations and conditions are changing rapidly, entities which are going to report their interim or annual financial statements with a reporting date in early 2020 (e.g. 31 March 2020) would face significant challenges when considering the events after the reporting date. Insurers are required to perform a careful analysis of the nature and impact of these subsequent events to determine if those events and conditions are adjusting or non-adjusting in accordance with IAS 10 *Events after the Reporting Period* (see section 13). Also refer to the discussion on impairment consideration of equity instruments classified as available for sale by insurance companies in section 3.

[2] Reimbursement rights of policyholders, other than the situation of a reinsurance contract held by a cedant, is covered in section 9, Insurance recoveries, of this publication.

Disclosure

Entities will need to disclose the assumptions used to make their estimates, highlight the uncertainties and explain the sensitivities of the measurement of the insurance liabilities if alternative assumptions were used, explaining how these are influenced by incorporating consequential effects of the coronavirus. Other disclosure items, like insurance risk concentrations, claims developments, credit risk, market risk and capital may be affected as well.

Even though the full extent of the impact on insurance entities may not be clear and a number of uncertainties around the impact may remain, disclosure explaining these uncertainties and possible effects will be needed. Such disclosure would need to include an explanation of events that happened after the reporting date, for any events that relate to conditions that existed at the end of the reporting period as well as for any events that relate to conditions that arose after the reporting period.

How we see it

The coronavirus outbreak will affect insurance entities as they deal with the effect of events on the insurance cover they provide, ranging from coverage related to changes in health status of policyholders due to the wide spread of the disease, to coverage for events related to disruption caused by the pandemic. However, this impact is expected to be much broader than the effect on the accounting for insurance liabilities as the current situation raises various challenges for insurers. For example, entities would have to identify and monitor new risks, and determine the magnitude of their impact on the insurance business. Entities would also have to deal with the impact of the developments on financial markets on their asset liability management strategies.

Given the rapid developments and extent of measures taken to contain the effects of the coronavirus outbreak, insurance entities should anticipate uncertainty over the impact on their insurance liabilities in the coming period, and will need to monitor developments closely and determine whether these developments have an impact on the accounting for their insurance liabilities.

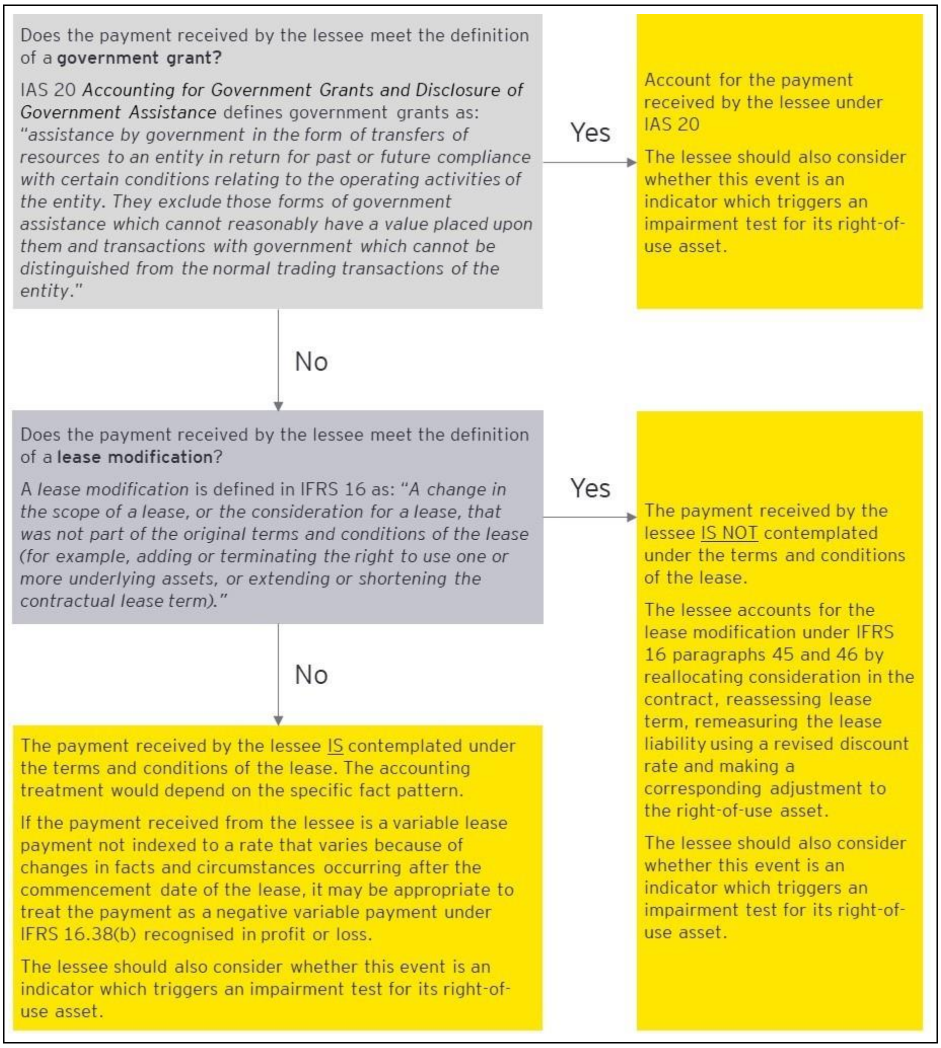
8. Leases

Payments received by the lessee

When payments are received by a lessee, it is necessary to evaluate whether IFRS 16 applies to such payments. In some jurisdictions, local authorities have implemented policies to provide subsidies to lessees and others in order to support the local economy and these payments are accounted for under IAS 20. Refer to section 5 for a discussion on the related accounting consideration.

When IFRS 16 applies to such payments made by a lessor, the lessee and lessor need to evaluate if there is a lease modification by considering the original terms and conditions of the lease. For example, a lessor may make a payment to a lessee of retail space in an airport when there are significant flight cancellations and such payment is not contemplated within the terms of the contract. In assessing whether the lease is modified, entities need to carefully evaluate terms of their contracts, including any *force majeure* clauses, which may, in specified circumstances, suspend some of their obligations or provide additional rights in the lease.

Figure 1: Assessing payments received (or receivable) by a lessee



A lease modification is a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease.

Under IFRS 16, a lease modification is a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease. For a lease modification that is not accounted for as a separate lease, at the effective date of the lease modification, a lessee is required to allocate the consideration in the modified contract, determine the lease term of the modified lease and remeasure the lease liability by discounting the revised lease payments using a revised discount rate. If the modification decreases the scope of the lease, the lessee accounts for the remeasurement of the lease liability by decreasing the carrying amount of the right-of-use asset to reflect the partial or full termination of the lease and recognises in profit or loss any gain or loss relating to the partial or full termination. For all other modifications, the lessee makes a corresponding adjustment to the right-of-use asset.

How we see it

The modification of the lease requires the remeasurement of the lease liability using a revised discount rate. Given that the interest rate implicit in the lease is generally not readily determinable by the lessee, it is necessary for the lessee to determine a revised incremental borrowing rate. The coronavirus outbreak has exacerbated market volatility and central banks in many jurisdictions are cutting interest rates. Assessing a revised incremental borrowing rate may also require judgement in these circumstances.

9. Insurance recoveries

A reimbursement is recognised when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation.

Requirements

In accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement is recognised when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The amount of the provision is not reduced by any expected reimbursement. Instead, the reimbursement is treated as a separate asset and the amount recognised for the reimbursement asset is not permitted to exceed the amount of the provision.

A contingent asset is defined as 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. An entity does not recognise a contingent asset because this may result in the recognition of income that may never be realised. However, when the realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate. A contingent asset is subject to disclosure where an inflow of economic benefits is probable. An entity needs to continually assess its contingent assets to ensure that developments are appropriately reflected in the financial statements. If an inflow of economic benefits has become probable (when, previously, it was possible but not probable), an entity is required to disclose the contingent asset. If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs.

Recognition

An entity may experience a loss related to the coronavirus outbreak. For example, as a result of the shutdown of its production facilities as required by the local government, an entity continues to incur expenses for staff costs, rent and property taxes. Entities often enter into insurance policies to reduce or mitigate the risk of loss arising from business interruption or other events.

The accounting for insurance claims will differ based on a variety of factors, including the nature of the claim, the amount of proceeds (or anticipated proceeds) and the timing of the loss and corresponding insurance recovery. In addition, any accounting for insurance proceeds will be affected by the evaluation of coverage for that specific type of loss in a given situation, as well as an analysis of the ability of an insurer to satisfy a claim.

In some instances, it may be clear that the recognition threshold for the reimbursement is met when the reimbursable expense is incurred. In other instances, a careful analysis of the terms and conditions of an entity's business interruption policies is required due to the wide variety of terms relating to the nature and level of losses covered. Some policies covering lost revenue or operating margins that typically are measured over a longer term require comparisons with similar periods in prior years. In such cases, no compensation would be available if revenue or operating margins recover during the measurement period that is set under the terms of the insurance policy. For example, a claim under a policy with a quarterly measurement period would not be valid if a retailer were to lose an entire month's revenue, but recover that revenue before the end of the quarter.

Decisions about the recognition (and measurement) of losses are made independently of those relating to the recognition of any compensation that might be receivable. It is not appropriate to take potential proceeds into account when accounting for the losses.

IAS 37 prohibits the recognition of contingent assets. In such a situation, the recognition of the insurance recovery will only be appropriate when its realisation is virtually certain, in which case, the insurance recovery is no longer a contingent asset. 'Virtually certain' is not defined in IAS 37, but it is certainly a much higher hurdle than 'probable' and, indeed, more challenging than the term 'significantly more likely than probable' in Appendix A of IFRS 5 *Non-current assets held for sale and discontinued operations*.[3] It is reasonable to interpret 'virtually certain' to be as close to 100% as to make any remaining uncertainty insignificant. In practice, this means that each case must be assessed on its own merits. In the context of a potential insurance recovery, determining that there is a valid insurance policy for the incident and a claim will be settled by the insurer, may require evidence confirming that the insurer will be covering the claim.

If a previously unlikely receipt becomes probable, but it is still a contingent asset, it will only be disclosed. This assessment extends to the analysis of information available after the end of the reporting period and before the date of approval of the financial statements. In applying IAS 10, an asset is recognised only if the information about the insurance recovery, that becomes available in the subsequent period, provides evidence of conditions that existed at the end of the reporting period and its realisation was virtually certain at that time. For example, the later receipt by the entity of confirmation from the insurer that its insurance policy does cover this type of loss would provide evidence of cover as at the end of the reporting period.

Measurement

Once it is established that it is virtually certain that the entity will be compensated for at least some of the consequences of the coronavirus outbreak under a valid insurance policy, any uncertainty as to the amount receivable should be reflected in the measurement of the claim.

Presentation

'Netting off' is not allowed in the statement of financial position, with any insurance reimbursement asset classified separately from any provision. However, the expense relating to a provision can be shown in the income statement net of any corresponding reimbursement.

In accordance with IAS 7 *Statement of Cash Flows*, cash flows from operating activities are described as cash flows from the principal revenue-producing activities of the entity and other activities that are not investing or financing activities. If the insurance proceeds are related to business interruption, the corresponding cash flows are classified as operating cash flows.

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[3] According to paragraph 23 of IAS 37, an event is regarded as probable if the event is more likely than not to occur.

How we see it

The terms and conditions of an insurance policy are often complex. In the context of a potential insurance recovery, determining that there is a valid insurance policy for the incident and a claim will be settled by the insurer, may require evidence confirming that the insurer will be covering the claim.

Once it is established that it is virtually certain that the entity will be compensated for at least some of the consequences of the coronavirus outbreak under a valid insurance policy, any uncertainty as to the amount receivable should be reflected in the measurement of the claim.

10. Onerous contract provisions

If an entity has a contract that is onerous, IAS 37 requires the entity to recognise and measure the present obligation under the contract as a provision.

Requirements

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. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it. If an entity has a contract that is onerous, IAS 37 requires the entity to recognise and measure the present obligation under the contract as a provision. Before a separate provision for an onerous contract is established, an entity recognises any impairment loss that has occurred on assets dedicated to that contract. See section 5 for further details on impairment considerations.

Recognition

One significant impact of the coronavirus outbreak is the disruption to the global supply chain. For example, when a manufacturing entity has contracts to sell goods at a fixed price and, because of the shutdown of its manufacturing facilities, as required by the local government, it cannot deliver the goods itself without procuring them from a third party at a significantly higher cost, the provision for the onerous contract will reflect the lower of the penalty for terminating the contract or the present value of the net cost of fulfilling the contract (i.e., the excess of the cost to procure the goods over the consideration to be received). Contracts should be reviewed to determine if there are any special terms that may relieve an entity of its obligations (e.g., *force majeure*). Contracts that can be cancelled without paying compensation to the other party do not become onerous as there is no obligation.

How we see it

In assessing the unavoidable costs of meeting the obligations under a contract at the reporting date, entities, especially those with non-standardised contract terms, need to carefully identify and quantify any compensation or penalties arising from failure to fulfil it.

11. Fair value measurement

IFRS 13 *Fair Value Measurement* specifies that fair value measurement (FVM) is a measurement date specific exit price estimate based on assumptions (including those about risks) that market participants would make under current market conditions. That is, at the measurement date, what assumptions would market participants have made using all available information, including information that may be obtained through due diligence efforts that are usual and customary. Unobservable inputs should be used to measure fair value to the extent that relevant observable inputs are not available. However, the fair value measurement objective remains the same, i.e., an exit price at the measurement date from the perspective of a market participant.

Following the above requirements, the objective of FVM is to convey the fair value of the asset or liability that reflects conditions as of the measurement date and not a future date. Although events and/or transactions occurring after the measurement date may provide insight into the assumptions used in estimating fair value as of the measurement date (only those that are unobservable), they are only adjusted for in FVM to the extent they provide additional evidence of conditions that existed at the measurement date and these conditions were known, or knowable, by market participants.

IFRS 13 also requires disclosure of information that helps users of financial statements assess the valuation techniques and inputs used to develop recurring fair values at the reporting date and, therefore, by implication the impact these FVMs will have on reported financial performance.

Measurement

Under IFRS 13, each FVM is categorised within the three levels in the FVM hierarchy based on the observability of inputs used. In Level 1 (unadjusted quoted prices in an active market for an identical asset or liability that an entity can access) and Level 2 (where all the inputs are observable for the asset or liability, either directly or indirectly, but are not in Level 1), the first quarter of 2020 has seen increasing market volatility. On the basis that these are still quoted prices in an active market or are still observable, the increase in volatility should not change the manner in which fair value is measured at the measurement date.

In Level 3 (where (an) unobservable input(s) is(are) significant to the measurement as a whole), incorporating such increase in volatility into valuation models may pose challenges to reporting entities. When making critical assessments and judgements for measuring fair value, the entity should consider what conditions, and corresponding assumptions, were known or knowable to market participants.

The impact on fair value measurement will depend on the evaluation of how the outbreak and actions taken by certain governments at the reporting date would have impacted market participants' valuation assumptions at that date.

While volatility in the financial markets may suggest that the prices are aberrations and do not reflect fair value, it would not be appropriate for an entity to disregard market prices at the measurement date, unless those prices are from transactions that are not orderly. The concept of an orderly transaction is intended to distinguish a fair value measurement from the price in a distressed sale or forced liquidation. The intent is to convey the current value of the asset or liability at the measurement date, not its potential value at a future date.

The impact on FVM would depend on the evaluation of how the outbreak and any actions taken by certain governments at the reporting date would have impacted market participants' valuation assumptions at that date. Accordingly, entities need to evaluate how this continuously changing information up to the reporting date potentially impacts related valuation inputs that were known, or knowable, by market participants by means of usual and customary due diligence performed up to that date.

The information available to the market at the reporting date may be relevant in making this evaluation. This would include any corroborative or contrary evidence, such as the timing and trajectory of observable market price movements of related assets in the relevant markets, as well as information from other than usual sources of market data up to the reporting date.

Disclosure

To meet the disclosure objectives of IFRS 13, entities will need to consider making related disclosures that could reasonably be expected to influence decisions that the primary users of general purpose financial statements would make on the basis of the financial statements. Depending on the facts and circumstances of each case, disclosure may be needed to enable users to understand whether or not the outbreak has been considered for the purpose of FVM. Users should understand the basis for selecting the assumptions and inputs that were used in the FVM and the related sensitivities.

Given the outbreak is evolving, entities are also reminded to consider the disclosure requirements from other standards that are relevant to FVM, such as IAS 10 *Events after the Reporting Period* on subsequent events and developments when asset values are significantly impacted subsequent to the reporting date. Furthermore, paragraph 125 of IAS 1 requires information regarding the assumptions an entity makes about the future and other sources of estimation uncertainty at the end of the reporting period, where such assumptions have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

How we see it

The objective of fair value measurement is to convey the current value of the asset or liability that reflects conditions as of the measurement date and not a future date. Accordingly, entities should consider what information about the outbreak was known, or knowable, to market participants at the reporting date in order to measure the fair value at the measurement date.

12. Revenue recognition

The coronavirus outbreak could affect revenue estimates in ongoing customer contracts in the scope of IFRS 15 *Revenue from Contracts with Customers*. This is because when a contract with a customer includes variable consideration (e.g., discounts, refunds, price concessions, performance bonuses and penalties), an entity is generally required to estimate, at contract inception, the amount of consideration to which it will be entitled in exchange for transferring promised goods or services. The amount of variable consideration an entity can include in the transaction price is constrained to the amount for which it is highly probable that a significant reversal of cumulative revenue recognised will not occur when the uncertainties related to the variability are resolved.

An entity that makes such an estimate is also required to update the estimate throughout the term of the contract to depict conditions that exist at each reporting date. This will involve updating the estimate of variable consideration (including any amounts that are constrained) to reflect an entity's revised expectations about the amount of consideration to which it expects to be entitled, considering uncertainties that are resolved or new information about uncertainties related to the coronavirus outbreak. Estimation of variable consideration and the constraint may require entities to exercise significant judgement and make additional disclosures. For example, an entity is required to disclose information about the methods, inputs and assumptions used for estimating variable consideration and assessing whether an estimate of variable consideration is constrained. Entities should also consider the requirements to disclose the judgements and changes in judgements that significantly affect the determination of the amount and timing of revenue.

Uncertainties related to the coronavirus outbreak could also prompt entities to modify contracts with customers or reassess whether it is probable that the entity will collect the consideration to which it is entitled. If both parties to a contract agree to amend the scope or price (or both) of a contract, an entity should account for the modification under the contract modification requirements in paragraphs 18-21 of IFRS 15. Significant judgement is required to determine when an expected partial payment indicates that: (1) there is an implied price concession to be accounted for as variable consideration; (2) there is an impairment loss (see section 3 on Individual and collective assessment of loans, receivables and contract assets); or (3) the arrangement lacks sufficient substance to be considered a contract under the standard.

Significant judgement may be needed to determine the effect of uncertainties related to the coronavirus on both ongoing and future revenue contracts.

In addition to the effect on ongoing contracts, entities will need to consider how the uncertainties with the coronavirus outbreak affect future contracts with customers. This could require careful consideration of, for example, collectability, price concessions and stand-alone selling prices. Entities may also need to consider how evolutions in their customary business practices affect their assessments under the revenue model. This could, for example, have an effect on an entity's determination that a valid contract exists, its identification of performance obligations and its assessment of whether it has a right to payment for performance completed to date.

Refer to our publication ***Applying IFRS: A closer look at IFRS 15, the revenue recognition standard***, for more information.

How we see it

Entities may need to use significant judgement to determine the effect of uncertainties related to the coronavirus outbreak on its revenue accounting, e.g., estimates of variable consideration (including the constraint) and provide appropriate disclosures. Importantly, the effects are unlikely to be limited to variable consideration. Decisions made in response to the outbreak (e.g., modifying contracts, transacting with customers during collectability concerns, revising pricing) may also have an effect on the accounting and disclosures for ongoing and future contracts.

The distinction between an adjusting and non-adjusting event is based on whether the event provides evidence of conditions that existed at the end of the reporting period.

13. Events after the reporting period

Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorised for issue. IAS 10 makes a distinction between adjusting and non-adjusting events after the reporting period. The principal issues are how to determine which events after the reporting period are to be reflected in the financial statements as adjusting events and, for non-adjusting events, what additional disclosures to provide.

Recognition

The coronavirus outbreak occurred at a time close to the end of 2019. In late 2019, a cluster of cases displaying the symptoms of a "pneumonia of unknown cause" were identified in Wuhan, the capital of China's Hubei province. On 31 December 2019, China alerted the World Health Organisation (WHO) of this new virus. On 30 January 2020, the International Health Regulations Emergency Committee of the WHO declared the outbreak a "Public Health Emergency of International Concern". Since then, more cases have been diagnosed, also in other countries. Measures were taken and policies imposed by China and other countries. On 11 March 2020, the WHO announced that the coronavirus outbreak can be characterised as a pandemic.

Many governments have introduced various measures to combat the outbreak, including travel restrictions, quarantines, closure of business and other venues and lockdown of certain area. These measures have affected the global supply chain as well as demand for goods and services. At the same time, fiscal and monetary policies are being relaxed to sustain the economy. These government responses and their corresponding effects are still evolving.

For entities that are affected, or expect to be impacted by the outbreak or by the measures taken, the critical judgement and evaluation that management need to make is whether and, if so, what event in this series of events provides evidence of the condition that existed at the end of the reporting period for the entity's activities or their assets and liabilities. When making this judgement, the entity takes into consideration all available information about the nature and the timeline of the outbreak and measures taken.

Disclosure

If management concludes an event is a non-adjusting event, but the impact of it is material, the entity is required to disclose the nature of the event and an estimate of its financial effect. For example, it may have to describe qualitatively and quantitively how the market volatility subsequent to year-end has affected its equity investments and governmental measures imposed on sporting and social activities and border controls have affected or may affect its operations, etc. If an estimate cannot be made, then the entity is required to disclose that fact.

How we see it

Entities need to ensure effective processes are in place to identify and disclose material events after the reporting period which could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements.

14. Other financial statement disclosure requirements

In addition to the disclosure requirements discussed in the above sections, IAS 1 requires disclosure of information about the assumptions concerning 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, such as non-current assets subject to impairment, within the next financial year (with the exception of assets and liabilities measured at fair value based on recently observed market prices). The disclosures are required to be presented in a manner that helps users of financial statements to understand the judgements that management makes about the future and about other key sources of estimation uncertainty. The nature and extent of the information provided will vary according to the nature of the assumption and other circumstances. Examples of the types of disclosures that an entity is required to make include:

- The nature of the assumption or other estimation uncertainty
- The sensitivity of carrying amounts 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
- An explanation of changes made to past assumptions concerning those assets and liabilities, if the uncertainty remains unresolved

When it is impracticable to disclose the extent of the possible effects of an assumption or other source of estimation uncertainty at the end of a reporting period, the entity discloses that it is reasonably possible, based on existing knowledge, that outcomes within the next financial year that are different from assumptions used could require a material adjustment to the carrying amount of the asset or liability affected.

An entity is also required to disclose the judgements, apart from those involving estimations, 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.

Disclosure (for year end reporting purposes)

The financial statement disclosure requirements for entities directly and/or indirectly affected by the outbreak will vary depending on the magnitude of the financial impact and the availability of information. Where such a decline in value is determined to be non-adjusting in accordance with the guidance described in the earlier sections, the entity does not adjust the carrying amounts, but instead, disclose such a fact and its financial effect if it can be reasonably estimated.

Because the outbreak may also result in obligations or uncertainties that an entity may not have previously recognised or disclosed, an entity also needs to consider whether to disclose additional information in the financial statements to explain the impact of the outbreak on areas that might include provisions and contingent assets/liabilities, in addition to asset impairments after the reporting period as discussed above.

The occurrence of the outbreak has certainly added additional risks that the carrying amounts of assets and liabilities may require material adjustments within the next financial year.

For entities which have their next quarterly reporting timeline close to the issuance of their annual financial statements, it is possible that quantitative financial information about the impact of the outbreak may become available by the time they issue the annual financial statements. In that case, they should consider providing such quantitative disclosures in their annual financial statements, if the effect is material.

In relation to the assumptions and estimation uncertainty associated with the measurement of various assets and liabilities in the financial statements, the occurrence of the outbreak has certainly added additional risks that the carrying amounts of assets and liabilities may require material adjustments within the next financial year. Therefore, entities should carefully consider whether additional disclosures are necessary in order to help users of financial statements understand the judgement applied in the financial statements. Such disclosure may include, for a financial statement item with a carrying amount that is more volatile in response to the outbreak, a sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation.

How we see it

Entities need to consider the magnitude of the disruptions caused by the outbreak to their businesses and adequately disclose the information about those assets and liabilities that are subject to significant estimation uncertainty, in order to provide users with a better understanding of the financial impact.

Disclosure (for interim reporting purposes)

In accordance with IAS 34, an entity is required to include in its interim financial report an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period. Information disclosed in relation to those events and transactions should also update the relevant information presented in the most recent annual financial report. IAS 34 includes a number of required disclosures as well as a non-exhaustive list of events and transactions for which disclosures would be required if they are significant. For example, where significant, an entity needs to disclose changes in the business or economic circumstances that affect the fair value of the entity's financial assets and financial liabilities, whether those assets or liabilities are recognised at fair value or amortised cost. In addition, an entity is also required to disclose any loan default or breach of a loan agreement that has not been remedied on or before the end of the reporting period and transfers between levels of the fair value hierarchy used in measuring the fair value of financial instruments where significant. The standard presumes a user of an entity's interim financial report will have access to the most recent annual financial report of that entity. Therefore, it is unnecessary for the notes to an interim financial report to provide relatively insignificant updates to the information that was reported in the notes in the most recent annual financial report. However, as most entities are only recently impacted by the outbreak which is rapidly evolving, they may not have included much relevant information in their last annual financial reports and thus may need to include more comprehensive disclosure on, especially, where relevant, the topics discussed in this publication for interim financial reporting purposes.

While other standards specify disclosures required in a complete set of financial statements, if an entity's interim financial report includes only condensed financial statements as described in IAS 34, then the disclosures required by those other standards are not mandatory. However, if disclosure is considered to be necessary in the context of an interim report, those other standards provide guidance on the appropriate disclosures for many of these items. In light of these requirements and depending on the entity-specific facts and circumstances, higher-level disclosures may be sufficient in condensed interim financial statements.

15. Other accounting estimates

Apart from the above, the following are some of the other key accounting estimates required to be made by management under IFRS. These estimates generally include management's assumptions about the future recoverability of an asset:

- Net realisable value of inventories under IAS 2 *Inventories*
- Remaining useful life and residual value of property, plant and equipment, intangible assets and right-of-use assets under IAS 16 *Property, Plant and Equipment*, and IAS 38 *Intangible Assets* and IFRS 16, respectively.

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A global set of accounting standards provides the global economy with one measure to assess and compare the performance of companies. For companies applying or transitioning to International Financial Reporting Standards (IFRS), authoritative and timely guidance is essential as the standards continue to change. The impact stretches beyond accounting and reporting to the key business decisions you make. We have developed extensive global resources — people and knowledge — to support our clients applying IFRS and to help our client teams. Because we understand that you need a tailored service as much as consistent methodologies, we work to give you the benefit of our deep subject matter knowledge, our broad sector experience and the latest insights from our work worldwide.

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