IFRS e COVID-19
Hot topics

15 dicembre 2020
Virtual seminar

Agenda

- Introduction
- Presentation and disclosure issues
- Measurement and recognition issues
- Closing remarks

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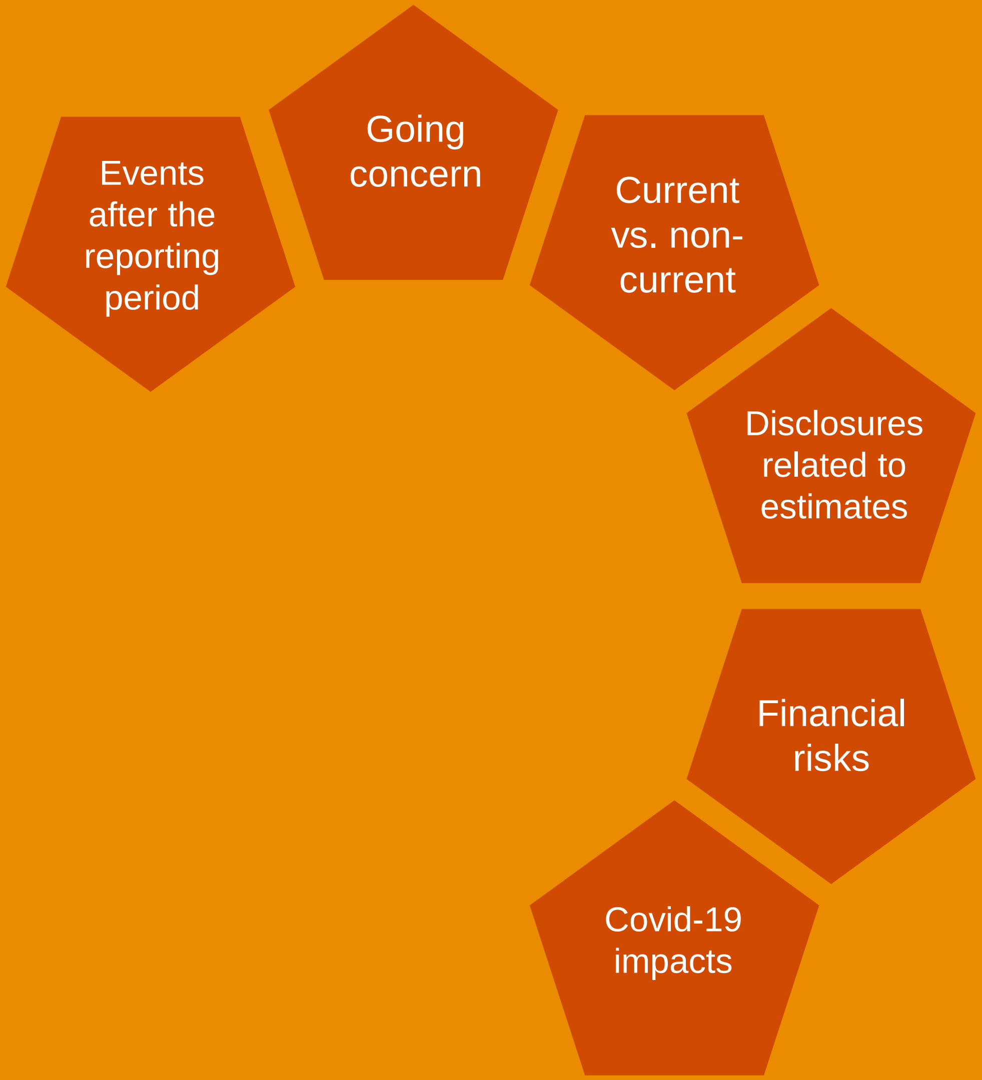
- Closing remarks

Presentation and disclosure issues

Beside the impact on measurement and recognition, COVID-19 also affects presentation and disclosure requirements.

Related questions could be:

Adjusting or non-adjusting event?
Going concern principle?
Current or non-current?
What specific disclosures are required as a result of economic changes (disclosures about significant estimates and judgements, financial risks, other disclosures)?

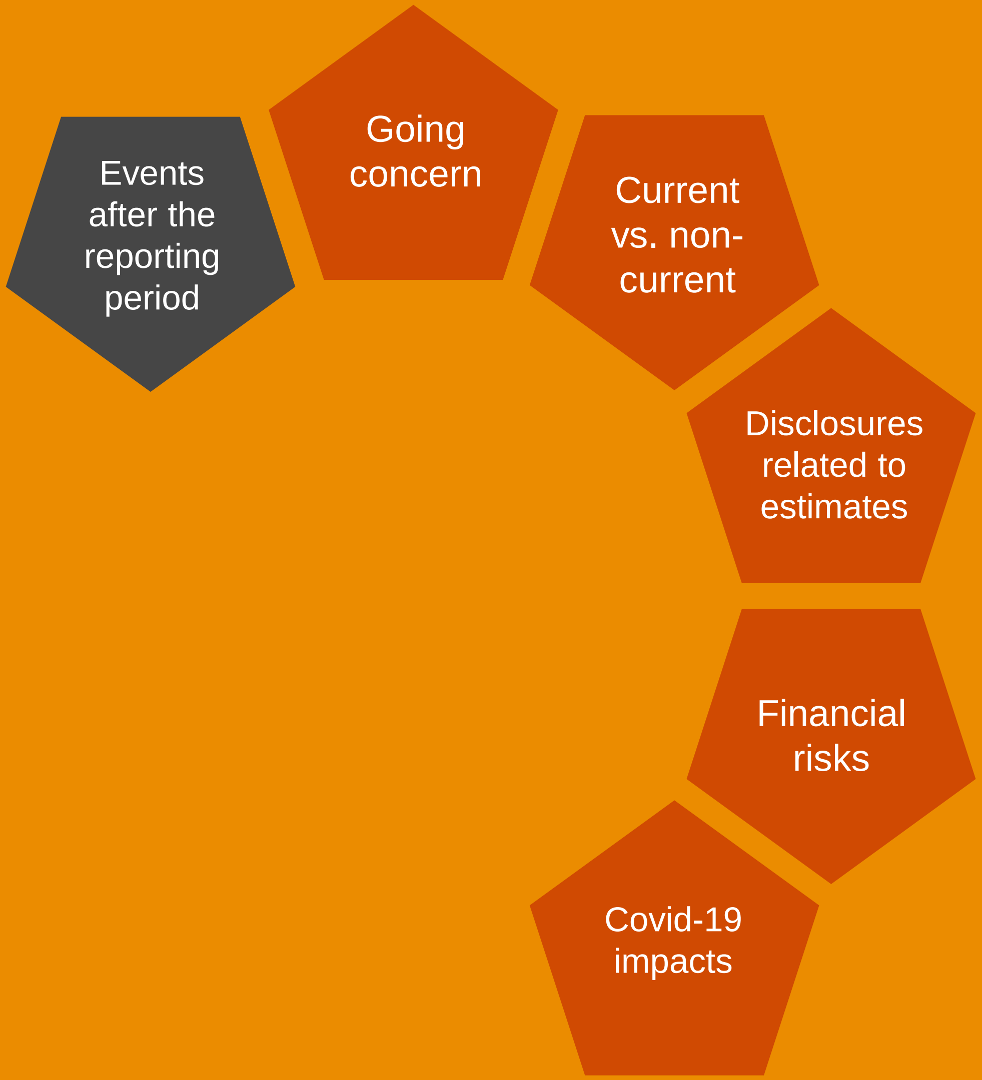


Presentation and disclosure issues

Events after the reporting period

As a result of COVID-19, it is very important to distinguish between **non-adjusting and adjusting events**, following the IAS 10 - *Events after the reporting period* standard's requirements.

All the events between the balance sheet date and the date when financial statements are authorized for issue should be taken into account to consider the **extent to which events occurring during this time should be reflected** in the financial statements.



Events after the reporting period

What do you think…?

Entity A's reporting date is 31 December 2020.

Entity A uses an income approach to measure the fair value of one of its assets. The model includes three scenarios that use Level 3 inputs. One of the scenarios incorporates a government lockdown and the other two do not.

After the end of the reporting period but before the financial statements are authorised for issue, the government imposes a lockdown. At the reporting date market participants would not have known that a lockdown was a certainty.

Should entity A adjust its model to have only one scenario with a 100% weighting?

Yes

No

Events after the reporting period

What do you think…?

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Should entity A adjust its model to have only one scenario with a 100% weighting?

Yes

No

Fair value measurement must reflect the assumptions that market participants would use when pricing the asset or liability. Since at the reporting date market participants would not have known that a lockdown was a certainty, entity A should not adjust its model to have only one scenario with a 100% weighting.

An entity should revise its fair value estimates only if reasonably available information indicates that other market participants would use different data.

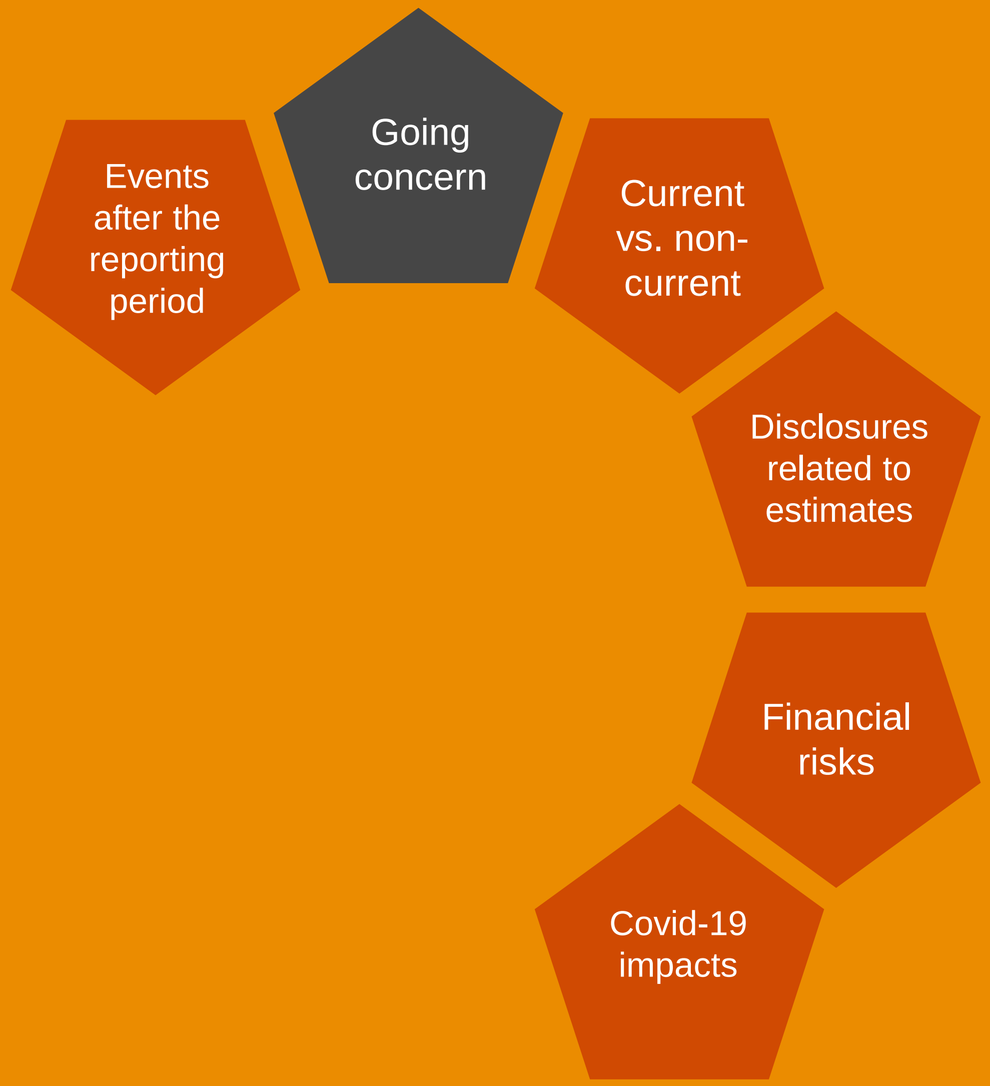
Presentation and disclosure issues

Going concern

According to the Conceptual framework for Financial Reporting and IAS 1, financial statements are prepared on a basis that assumes an "… entity is a going concern and will continue in operation for the foreseeable future".

According to IAS 10 management should assess the entity's ability to continue as a going concern at the time of preparing the financial statements. In other words, **all** subsequent events are considered adjusting when considering the going concern assumption.

Material uncertainties that might cast significant doubt upon an entity's ability to continue as a going concern, and its financial statements continue to be prepared on the going concern basis, should be disclosed in accordance with IAS 1.



Presentation and disclosure issues – Going concern

What do you think…?

If the impact of COVID-19 is such that, after the reporting date but before the financial statements are issued, management intends to liquidate the entity, is it treated as an adjusting event?

Yes, it is an adjusting event

No, it is not an adjusting event

Presentation and disclosure issues – Going concern

What do you think…?

If the impact of COVID-19 is such that, after the reporting date but before the financial statements are issued, management intends to liquidate the entity, is it treated as an adjusting event?

Yes, it is an adjusting event

No, it is not an adjusting event

That's right!

The going concern basis of preparation is not applied to financial statements if events after the balance sheet date indicate that the going concern assumption is no longer appropriate! In other words, any information related to going concern is considered to be an adjusting and should be considered when making the going concern assumption.

Management should take into account all the potential implications of economic changes and measures taken by governments in its assessment of going concern. An entity should not prepare its financial statements on the going concern basis if management determines, after the reporting period, that it:

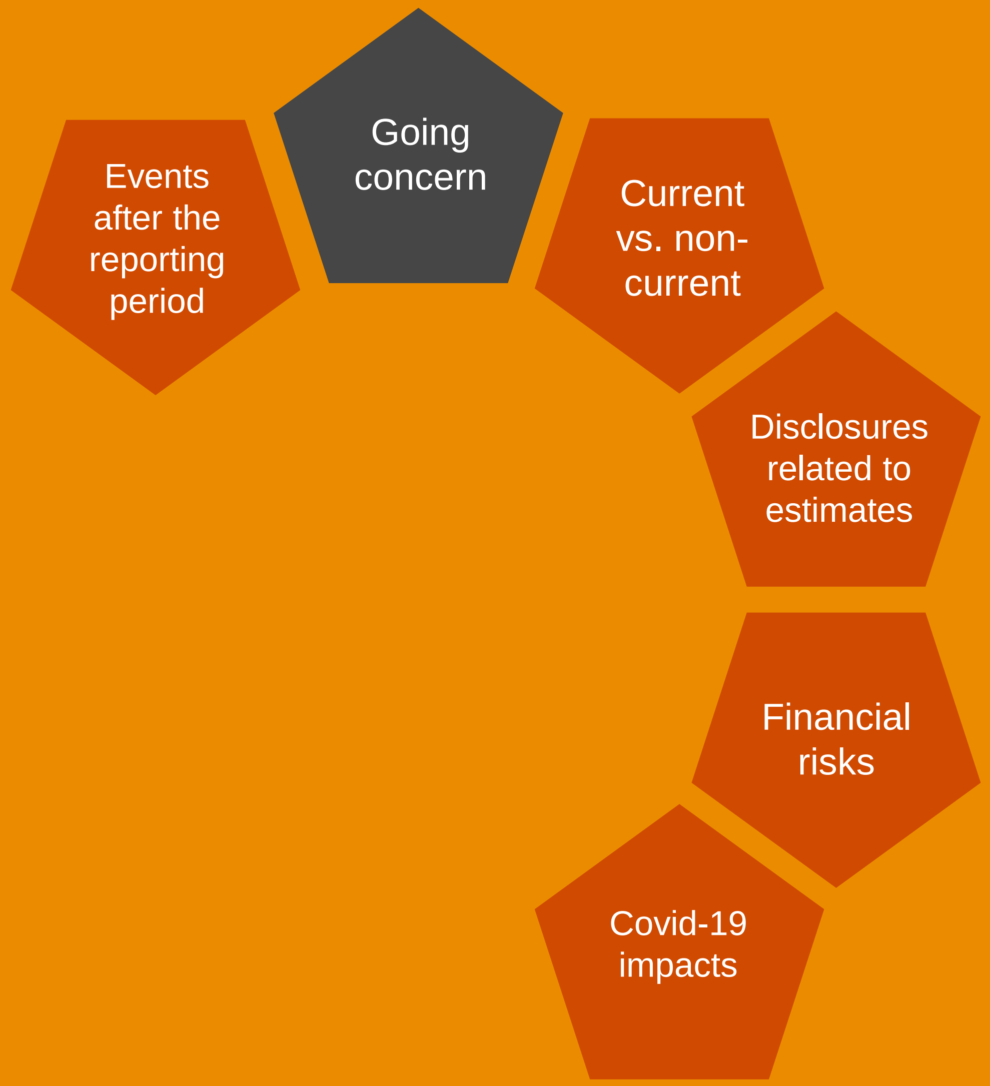
- intends to liquidate the entity or to cease trading; or
- has no realistic alternative but to do so (even if the liquidation or cessation occurs more than 12 months after the balance sheet date).

Presentation and disclosure issues

Going concern

Factors to consider when writing the going concern paragraph in the notes to the financial statements:

- **Be as specific as possible about how the entity is affected;**
- **Be complete;**
- **Expect the unexpected;**
- **Describe mitigating actions;**
- **Include a conclusion.**



Presentation and disclosure issues

Events

Going concern

Current

Going concern

Factors to consider when writing the going concern paragraph in the notes to the financial statements:

- Be as specific as possible about how the entity is affected;

- Be complete;

- Expect the unexpected;

- Describe mitigating actions;

- Include a conclusion.

Be as specific as possible about how the entity is affected

The entity should disclose the consequences of the current situation with regard to, for example:

- revenue: declining markets, significant drop in demand in major markets
- customers: impact of effects of COVID-19 on customers, impairment
- suppliers: production process that largely depends on the supply of goods from an infected area
- employees: consequences of possible lock-downs on productivity
- delay in expected investments
- liquidity, possible breaches of covenants, the continued availability of funding and credit facilities, etc.

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Presentation and disclosure issues

Events

Going concern

Current

Going concern

Factors to consider when writing the going concern paragraph in the notes to the financial statements:

- **Be as specific as possible about how the entity is affected;**
- **Be complete;**
- **Expect the unexpected;**
- **Describe mitigating actions;**
- **Include a conclusion.**

Be complete

If other factors - in addition to COVID 19 - also cast significant doubt about the entity's ability to continue as a going concern, the entity should also disclose those other factors.

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Presentation and disclosure issues

Events

Going concern

Current

Going concern

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- **Expect the unexpected;**
- **Describe mitigating actions;**
- **Include a conclusion.**

Expect the unexpected

In addition to specific disclosures about how the entity's ability to continue as a going concern is affected by the implications of COVID-19 and government measures that are currently known, an entity should also consider disclosing that it is an uncertain situation and how things may change and how that would affect the entity.

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Events

Going concern

Current

Going concern

Factors to consider when writing the going concern paragraph in the notes to the financial statements:

- **Be as specific as possible about how the entity is affected;**
- **Be complete;**
- **Expect the unexpected;**
- **Describe mitigating actions;**
- **Include a conclusion.**

Describe mitigating actions

An entity might also disclose the measures that it is taking to mitigate the possible negative impacts of the COVID-19 outbreak.

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Events

Going concern

Current

Going concern

Factors to consider when writing the going concern paragraph in the notes to the financial statements:

- **Be as specific as possible about how the entity is affected;**
- **Be complete;**
- **Expect the unexpected;**
- **Describe mitigating actions;**
- **Include a conclusion.**

Include a conclusion

If appropriate, conclude the note with a statement that the entity has determined that the use of the going concern assumption is warranted.

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Presentation and disclosure issues

Current vs. non-current classification

According to IAS 1 - *Presentation of financial statements* information about **expected dates of realisation** of assets and liabilities is useful in assessing the liquidity and solvency of an entity, especially under challenging circumstances, such as COVID-19.

Let's discuss the **current vs. non-current** classification of assets and liabilities and the implications of **breaches of covenant and the potential impact on an entity's ability to continue as a going concern,** which we have discussed previously**.** This is particularly relevant in the context of COVID-19.

Presentation and disclosure issues - Current vs. non-current

What do you think…?

Entity A's bank borrowings consists of two significant loans (Loan 1 and Loan 2), and one smaller loan (Loan 3). All of the loans have contractual maturities beyond 12 months after the end of the reporting period and they also have specific covenants. The agreement for Loan 1 contains a specific cross default clause, according to which if any of the entity's loan covenants are breached, Loan 1 becomes immediately repayable. Entity A continuously monitors and predicts whether the covenants on Loan 1 and Loan 2 will be breached, because Loan 1 or Loan 2 becoming immediately repayable would cause significant liquidity issues. Since Loan 3 is not significant in value, Entity A does not specifically focus on this loan's covenants.

Are there any issues for Entity A to be aware of?

As Entity A continuously monitors compliance with the covenants in significant loans, it is unlikely that there will be any unexpected liquidity issues arising from its borrowings.

Entity A might have an unexpected liquidity issue if Loan 3's covenants are breached.

Presentation and disclosure issues - Current vs. non-current

What do you think…?

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Are there any issues for Entity A to be aware of?

As Entity A continuously monitors compliance with the covenants in significant loans, it is unlikely that there will be any unexpected liquidity issues arising from its borrowings.

Entity A might have an unexpected liquidity issue if Loan 3's covenants are breached.

That's right!

Although Loan 3 is of insignificant in value, it is linked to Loan 1, because of the cross default clause in Loan 1. Management of Entity A is right to monitor compliance with the covenants of Loan 1 and Loan 2, because these loans could cause liquidity issues for the entity, however entity A should also consider compliance with the covenants required by Loan 3.
If Loan 3's covenants are breached, Loan 1 will also become immediately repayable due to the cross-default clause.

Entity A should focus on all covenants for even insignificant loans in order to idenity liquidity issues before they arise.

Presentation and disclosure issues

Disclosures related to estimates

Each IFRS **standard has separate disclosure requirements**, which might require extensive disclosure as a result of COVID-19. For the discussed topics during this seminar, related disclosure requirements should be carefully considered.

Several example can be seen on the next page. All these disclosures might need to be **tailored in the current year** as a result of the impact of the virus. The extent of disclosures regarding estimation uncertainty might need to be increased. For example, the carrying amount of more items might be subject to a material change within the next year. There might be individually significant effects of the virus – for example, individually material expenses such as an impairment or a modification adjustment.

In addition, according to IAS 1 an entity must disclose significant accounting policies, the most significant judgements made in applying those accounting policies, and the **assumptions** that it makes about the future, and other **major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts** of assets and liabilities **within the next financial year**.

Presentation and disclosure issues - Disclosures related to estimates

See below the potential impact of COVID-19 on severall disclosures!

Impairment of non-financial assets (IAS 36)	Inventories (IAS 2)	Impairment of financial assets (IFRS 7)	Financial instruments (IFRS 7)	Fair value (IFRS 13)
Sensitivity analyses of possible outcomes that might result in a goodwill impairment.	Basis and sensitivities of significant write-downs to net realisable value.	Explanation of how COVID-19 was incorporated into forward-looking information for the ECL estimate and staging, including the effect of uncertainties and assumptions used for scenarios.	Disclosure on breaches of covenants on loans payable.	If level 3 fair value estimation methods need to be adjusted as a result of COVID-19, an explanation of why and how this change was made.
Additional disclosure on key assumptions and uncertainties in the recoverable amount calculation.			Disclosure on effects of modification and/or derecognition of loans due to COVID-19.	Any transfers between fair value hierarchy levels where market liquidity worsened due to COVID-19.

Presentation and disclosure issues - Disclosures related to estimates

See below the COVID-19 specific additional disclosures!

Revenue (IFRS 15)	Provision (IAS 37)	Share-based payments (IFRS 2)	Deferred tax asset (IAS 12)
Disclosure on significant judgements about customer’s ability to pay, significant estimates about variable consideration and additional concessions that might be provided to customers due to COVID-19.	Disclosure on assumptions and basis under which any contracts became onerous as a result of COVID-19.	Disclosure on scale, reason and accounting impact of modifications to share-based payments to protect employees as a result of negative impacts to awards with performance conditions.	Disclosure on significant judgements and estimates made in assessing if sufficient future taxable profit will be available. In particular how recoverability is still probable in light of the negative impact to taxable profit as a result of COVID-19.

ISA 540 (Revised) "Auditing Accounting Estimates and Related Disclosures"

Summary of key changes

Risk assessment

- More detailed requirements around obtaining understanding of the entity and its environment
- Detailed requirements for assessing estimation uncertainty, complexity, subjectivity and other inherent risk factors for all estimates
- Requirement to consider spectrum of inherent risk as basis for 'scaling' audit response

Testing of internal controls

- Emphasis on the auditor's understanding relevant to estimates and consideration of whether to test operating effectiveness as part of the overall audit plan

Audit response

- More detailed requirements for testing methods, significant assumptions and data
- Expanded requirements regarding audit evidence when developing auditor's point estimate or range

Disclosures

- Evaluation of disclosures alongside the accounting estimate for risk assessment and testing
- Requirement to consider whether disclosures adequately address estimation uncertainty

Completion and communications

- Emphasized requirements regarding communications with those charged with governance

ISA 540 (Revised) is the enhanced standard for auditing accounting estimates and becomes effective for periods commencing on or after 15 December 2019. The revised standard enhances and expands on the existing requirements of extant ISA 540 considerably in a number of key areas. These revised requirements will, in many cases, have a significant impact on the robustness of our risk assessment procedures and the resulting extent of audit work we perform.

The table on the left summarizes the areas of change expected to have the most significant impact when addressing the requirements of the revised standard.

All of these changes will likely result in an increased level of audit documentation.

Financial risks

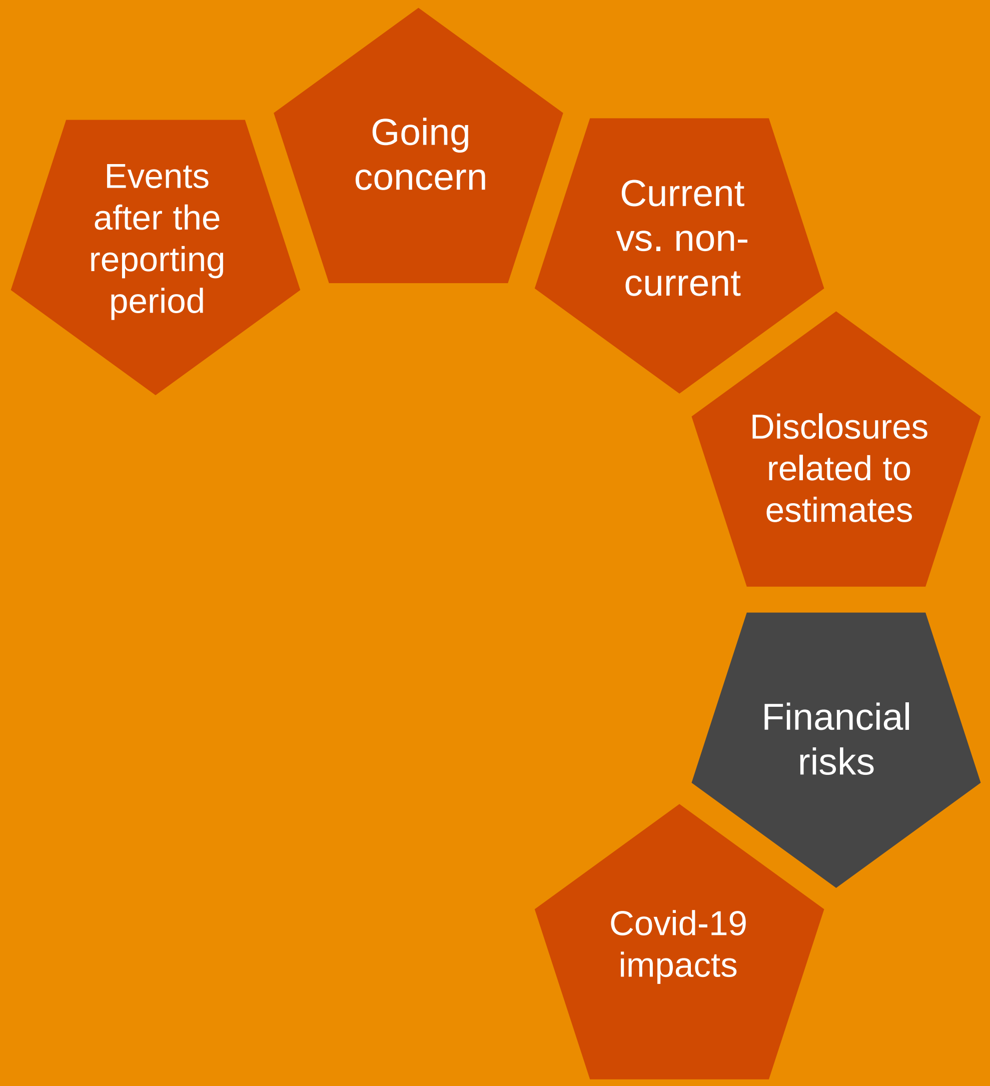
IFRS 7 *Financial instruments: Disclosures* has extensive disclosure requirements relating to financial risks. IFRS 7's objective is to provide information to users of financial statements about an entity's **exposure to risks and how the entity manages those risks**.

Credit risk

Liquidity risk

Market risk

Entities will need to disclose any changes in their financial risks such as credit risk, liquidity risk, currency risk and other price risk, or in their objectives, policies and processes for managing those risks. In particular additional disclosures about liquidity risk might be needed where COVID-19 has affected an entity's normal levels of cash inflows from operations or its ability to access cash in other ways such as from factoring receivables or supplier finance.

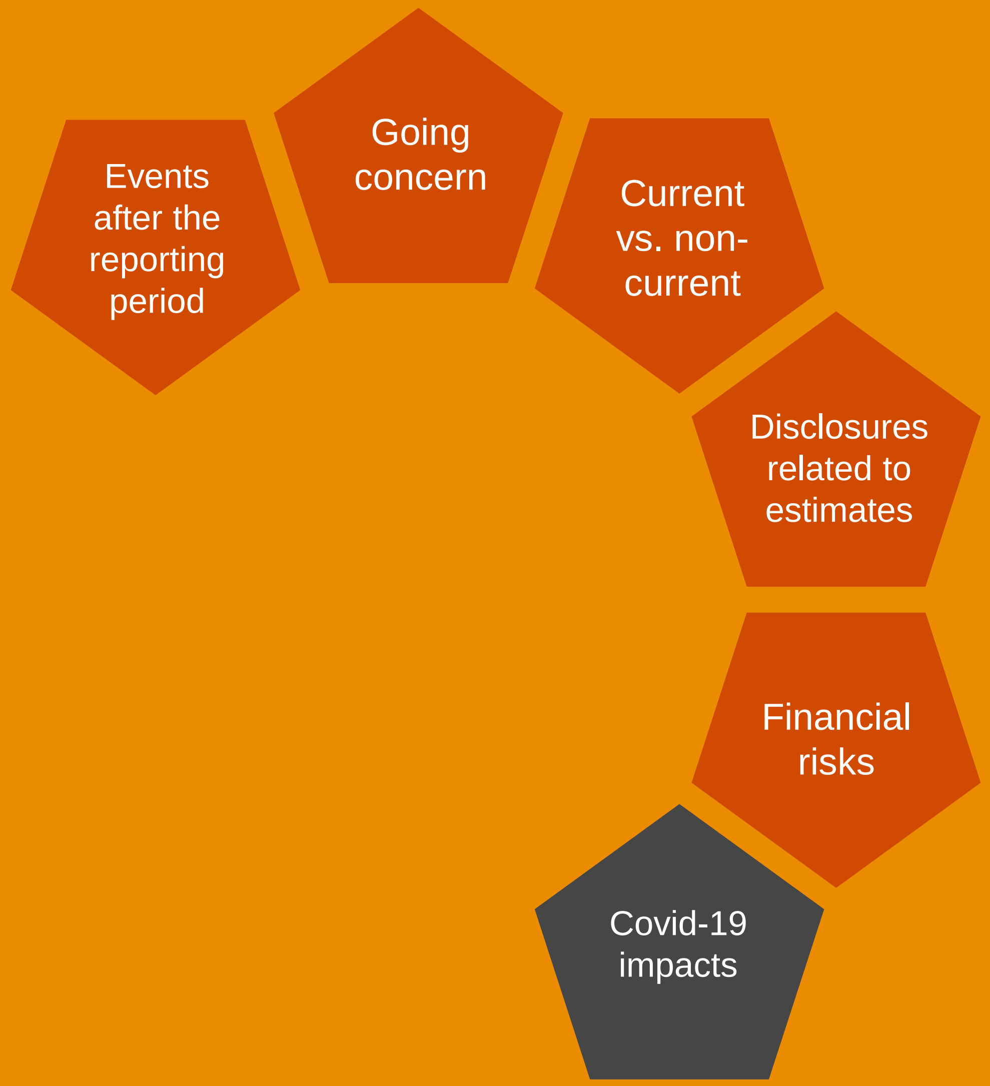


Presentation and disclosure issues

Covid-19 impacts

Users of financial statements would like to see detailed information about the effects of COVID-19. Although the purpose of financial statements is to provide useful information to its users about the entity’s financial position, financial performance and cash flows in making economic decisions, some of these stakeholder’s needs might be met more appropriately by disclosure outside the financial statements.

Management might consider **updating its analysis of the principal risks and uncertainties**. Management should also consider any **specific local disclosure requirements**, for example, those issued by a local securities regulator.



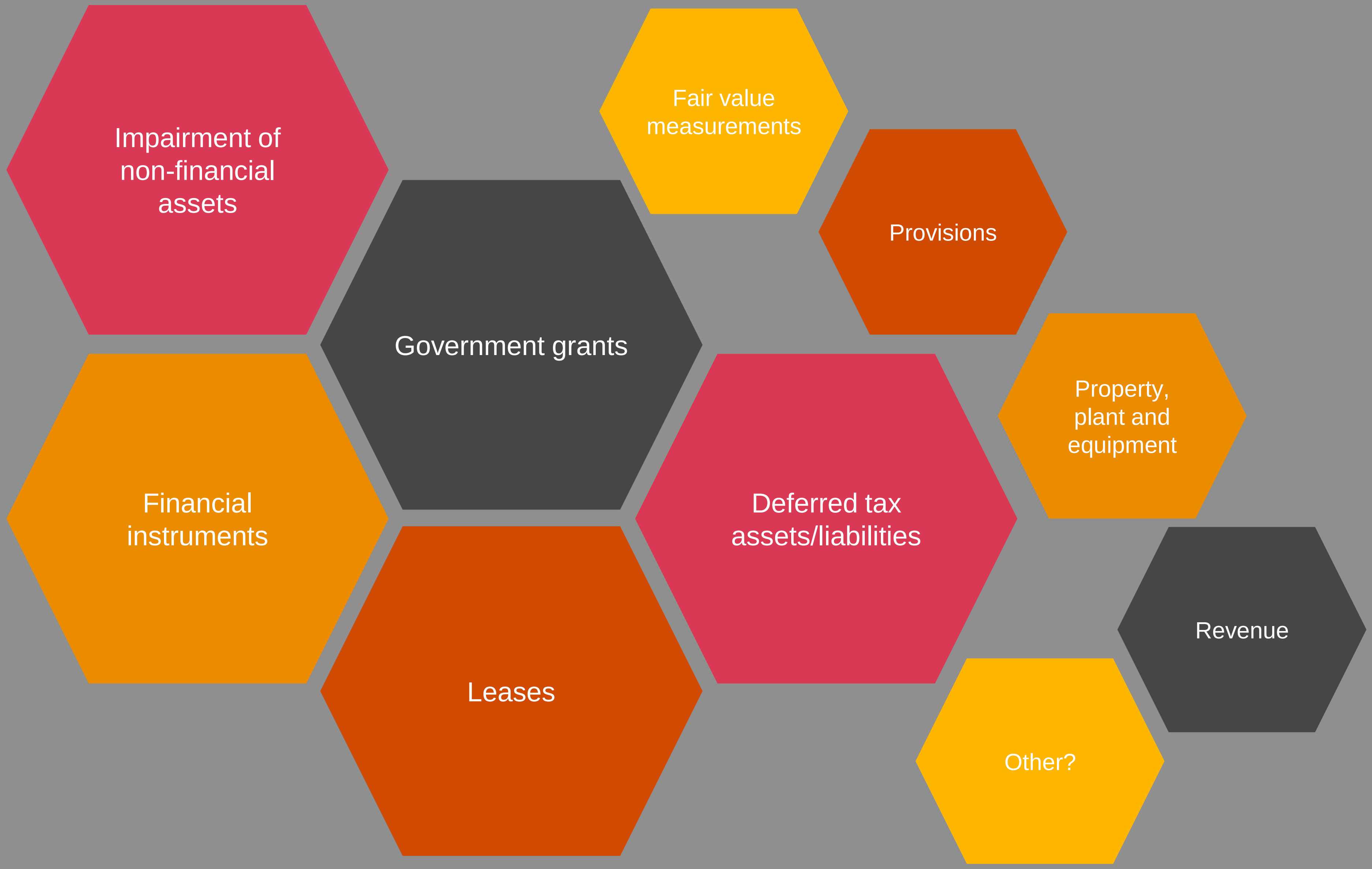
Agenda

- Introduction
- Presentation and disclosure issues
- Measurement and recognition issues
- Closing remarks

Measurement and recognition issues

This seminar will cover measurement and recognition issues of the following items:

Please note, that this is not an exhaustive list of all the possible accounting implications. Each entity needs to analyze its own conditions and circumstances and, based on that assessment, should decide on the correct accounting treatment.



Measurement and recognition issues

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Please note, that this is not an exhaustive list of all the possible accounting implications. Each entity needs to analyze its own conditions and circumstances and, based on that assessment, should decide on the correct accounting treatment.

- Impairment of non-financial assets
- Fair value measurements
- Provisions
- Government grants
- Property, plant and equipment
- Financial instruments
- Deferred tax assets/liabilities
- Revenue
- Leases
- Other?

Impairment of non-financial assets

Goodwill, property, plant and equipment, intangibles

Inventories

Investments in subsidiaries, associates and joint ventures

IAS 36 – Impairment of assets deals with impairment requirements for non-current non-financial assets and also applies to financial assets classified as subsidiaries, associates and joint ventures.

The basic principle of impairment is that an asset cannot be carried in the balance sheet at more than its recoverable amount.

The standard requires that **goodwill, indefinite life intangible** assets and **intangible assets that are not yet ready for use** are tested for impairment at least **annually.**

Other non-financial assets are tested for impairment whenever **there is an indicator** that those assets might be impaired. An entity should at each reporting date (that is at year end and at interim reporting dates in accordance with IAS 34 - *Interim financial reporting*) assess whether there are any indicators for impairment.

Recoverable amount

higher of

Fair value less costs of disposal

Value in use

in accordance with IFRS 13: fair value is the price that would be received to sell the asset in an orderly transaction between market participants at the measurement date

present value of the future cash flows that are expected to be derived from the asset

Impairment of non-financial assets – Goodwill, property, plant and equipment, intangibles

Examples of COVID-19 specific indicators of impairment:

- permanently or temporarily closing retail stores,
- ceasing production, operating at significant reduced capacities
- customers and/or suppliers in financial difficulties that have impacted sales and supplies
- government restrictions impacting the industry such as closing borders, restricting travel, requiring people to isolate at home

COVID-19 may not be considered a triggering event for impairment testing in its own right. However, it might result in any number of the following indicators:

- Actual revenues are significantly lower than the original budget.
- Operating cash flows are significantly lower than earlier forecasts.
- Material decreases in mid-term and/or long-term growth rates, as compared to the previous estimates.
- Significant or prolonged decrease in the entity's stock price.
- Market capitalisation is below the book value of net assets.
- Announcement of changes in business model, restructuring or discontinued operations.
- Increases in the cost of capital.
- Change of market interest rates or other market rates of return.
- Fluctuations in the foreign exchange rates or commodity prices that negatively impact the entity's cash flows.
- Deferral of investment projects.
- Restrictions on operations such as inability to import, export, or travel

COVID-19 specific indicators of impairment

Impairment of non-financial assets – Goodwill, property, plant and equipment, intangibles

As we have demonstrated, as a result of COVID-19 there will most probably be an indicator for impairment.

How should we measure the impairment?

It is important that **assumptions and cash flow forecasts** used to test for impairment **should be updated** to reflect the potential impact of a given circumstance.

Budgets, forecasts and other assumptions from an earlier impairment testing date that were used to determine the recoverable amount of an asset **should be revised to reflect the economic conditions** at the balance sheet date, specifically to address **increased risk and uncertainty**.

Fair value less costs of disposal will always be **the fair value of the asset at balance sheet date** less costs of disposal.

When fair value is used to determine the recoverable amount, the assumptions made should reflect **market participant assumptions**.

Determining **value in use** can be more challenging, because it involves estimates. The **cash flows** consist of those expected to arise from the continued use of the asset or CGU (cash generating unit) in its current condition and those, if any, expected to result from its ultimate disposal.

Projected future cash flows are then **discounted** at a rate that reflects both current market assessments of the time value of money and the risks specific to the asset for which the future cash flow estimates have not been adjusted.

Risk must be incorporated into the cash flow model, to reflect uncertainty. Risks include variations in amount and timing of cash flows and uncertainty inherent in the asset. This can be reflected either in the discount rate or in the cash flows.

There are two approaches to estimate cash flows.

1

The traditional approach
It uses a single set of cash flows and a single discount rate. This approach incorporates a majority of the risk in the discount rate.

2

The expected cash flow approach
Unlike the traditional approach, it incorporates a majority of the risk in the cash flows. It is a method using multiple probability-weighted cash flow scenarios.

Impairment of non-financial assets – Goodwill, PP&E, intangibles - Test your understanding!

Which approach could be more suitable under circumstances of COVID-19?

Traditional approach

Expected cash flow approach

Impairment of non-financial assets – Goodwill, PP&E, intangibles - Test your understanding!

Which approach could be more suitable under circumstances of COVID-19?

Traditional approach

Expected cash flow approach

An expected cash flow approach might be a better way to estimate recoverable amount under circumstances of COVID-19 in order to capture the increased risk and uncertainty.

The potential impact of special measures could be included as additional scenarios.

There might be a range of potential outcomes considering different scenarios.

Impairment of non-financial assets – Goodwill, PP&E, intangibles - Test your understanding!

Do we have to revise the discount rate used to calculate value in use under circumstances of COVID-19?

Yes

No

Impairment of non-financial assets – Goodwill, PP&E, intangibles - Test your understanding!

Do we have to revise the discount rate used to calculate value in use under circumstances of COVID-19?

Yes

No

The discount rate used in a traditional approach should be adjusted to incorporate the actual risk.

The factors used to determine the discount rate, should be revised to reflect the impact of new circumstances and the measures taken to control them, for example the risk free rate, country risk and asset risk.

Management should ensure that appropriate risk is reflected in either the cash flows or the discount rate.

Impairment of non-financial assets

Goodwill, property, plant and equipment, intangibles

Inventories

Investments in subsidiaries, associates and joint ventures

Impairment of non-financial assets - Subsidiaries, associates and joint ventures

The accounting treatment of **investments in subsidiaries, associates and joint ventures** depends on whether the entity prepares **consolidated** financial statements **or separate** financial statements.

The previous slides covered requirements of IAS 36. Now let's explore the investment related impairment requirements of IAS 28 and IFRS 9.

For entities preparing
consolidated financial statements

For entities preparing
separate financial statements

Impairment of non-financial assets - Subsidiaries, associates and joint ventures

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For entities preparing **consolidated financial statements**

For entities preparing **separate financial statements** +

Related standard for the equity accounted investment in an associate and joint venture:

IAS 28 - *Investments in Associates and Joint Ventures* **and**
IAS 36 - *Impairment of assets*

Impairment of non-financial assets - Subsidiaries, associates and joint ventures

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For entities preparing
consolidated financial statements
+

For entities preparing
separate financial statements

The accounting policy selected for measuring investments according to IAS 27 - *Separate financial statements* determines the relevant standard applicable:

- The related standard for investments that are carried at **cost** in separate financial statements**: IAS 36** - *Impairment of assets*
- The related standard for interests that are accounted for under the **equity method**: **IAS 28** - *Investments in Associates and Joint Ventures* **and IAS 36 -** *Impairment of assets*.
- The related standard for interests in subsidiaries, joint ventures and associates that are in the scope of IFRS 9: **IFRS 9** - *Financial instruments.*

Impairment of non-financial assets – Subsidiaries, associates and joint ventures

Interests in joint ventures and associates accounted for under the equity method

According to **IAS 28** - *Investments in Associates and Joint Ventures* these investments are tested for impairment, where **there is an indicator** of impairment.

- Significant adverse changes in the technological, market, economic or legal environment in which the associate or the joint venture operates;
- A significant or prolonged decline in the fair value of the associate or the joint venture below its cost;
- Significant financial difficulty;
- A breach of contract, such as a default or delinquency;
- The investor grants the associate or joint venture a concession that the entity would not otherwise consider because of the investee’s financial difficulty;
- It appears probable that the associate or joint venture will enter bankruptcy or other financial reorganisation; or
- The disappearance of an active market for the shares of the associate or joint venture.

If there is an indicator that the interest might be impaired, the measurement rules in IAS 36 are applied.

Management should consider whether the impact of COVID-19 and the measures taken to control it are an indicator that an associate or joint venture is impaired.

Impairment of non-financial assets – Subsidiaries, associates and joint ventures

What do you think…?

The carrying amount of an investment in an associate at reporting date is CU 1,000 and the investment consists of 500 shares. The share price of the investment at the reporting date is 1.5 CU/share, previously it was 2.2 CU/share.

Based on this information is it necessary to recognize an impairment?

Yes – Fair value of the investment is lower than its carrying value, an impairment must be recognised.

No – The value in use must be also determined. If the value in use is higher than the carrying amount of the investment, there is no need to recognise an impairment.

Impairment of non-financial assets – Subsidiaries, associates and joint ventures

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No **– The value in use must be also determined. If the value in use is higher than the carrying amount of the investment, there is no need to recognise an impairment.**

The price decline is an indicator and establishes the ‘fair value less costs of disposal’ of the associate. But the recoverable amount using the ‘value in use’ method should also be calculated before recording an impairment loss. If the value in use is higher than the carrying amount of the investment, there is no impairment to recognise.

Calculating the value in use of an associate might entail obtaining cash flow forecasts from the associate’s management. The future expected dividend streams from the investment in the associate could also be used in measuring the associate’s value in use. Please note, that these dividend streams are post tax and post financing cash flows, so the models need to be adjusted to get to the dividend flow or investor returns.

Interests in subsidiaries, joint ventures and associates that are in the scope of IFRS 9

IFRS 9 – *Financial instruments*

Investments, which are in the scope of IFRS 9 as a result of an accounting policy choice of an entity according to IAS 27 shall be initially and subsequently **measured at fair value**.

The default measurement category **is fair value through profit or loss**, but an entity can make an irrevocable election on initial recognition, on an instrument-by-instrument basis, to present subsequent changes in **fair value in other comprehensive income (OCI)**.

If this election is made, all fair value changes, excluding certain dividends, will be reported in OCI and there is no recycling of amounts from OCI to profit and loss**, nor are there any impairment requirements.**

Impairment of non-financial assets

Goodwill, property, plant and equipment, intangibles

Inventories

Investments in subsidiaries, associates and joint ventures

Impairment of non-financial assets – Inventories

According to IAS 2 - *Inventories*, carrying value of inventories at reporting date should not be higher than their **net realizable value**.

What could the possible effects of COVID-19 be?

Impairment of non-financial assets – Inventories

According to IAS 2 - *Inventories*, carrying value of inventories at reporting date should not be higher than their **net realizable value**.

What could the possible effects of COVID-19 be?

reduced movement in inventory

lower sales prices

inventory obsolescence due to lower than expected sales volumes

Impairment of non-financial assets – Inventories

How should we determine the net realisable value?

Estimates of net realisable value are based on the most reliable evidence available at the time the estimates are made, of the amount the inventories are expected to realise. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the end of the period, to the extent that such events confirm conditions existing at the end of the period.

Do we have impacts on the way we determine cost as well?

In addition to the question of impairment calculation on inventories, we must keep in mind that IAS 2 requires that **fixed production overheads are included** in the cost of inventory **based on normal production capacity**. Reduced production as a result of COVID-19 might affect the extent to which overheads can be included in the cost of inventory.

Impairment of non-financial assets – Inventories

How should we determine the net realisable value?

Estimates of net realisable value are based on the most reliable evidence available at the time the estimates are made, of the amount the inventories are expected to realise. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the end of the period, to the extent that such events confirm conditions existing at the end of the period.

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According to IAS 10 **sale of inventories after the reporting date** in most cases provides evidence of the **net realisable value** at the reporting date (it is an example of an adjusting event). Since the condition (store closures due to COVID 19) existed at the year end, the post balance sheet confirmation of the new sales price and the resultant loss **should be reflected in the carrying value of the inventories at the year end**.

Impairment of non-financial assets - Inventories - Test your understanding!

The following information is relevant for entity A's inventory:

- Normal capacity is 7,500 labour hours per quarter.
- Actual labour hours for Q1 are 3,000 hours, because the factory was closed part way through Q1 due to government lockdown.
- Total fixed production overhead is CU 1,500.
- Total variable production overhead is CU 2,700.
- Total units produced in the quarter are 3,000 units, because the factory was run at reduced capacity.

How entity A should allocate the overhead (1,500 + 2,700 = CU 4,200) to units produced?

CU 4,200 / 7,500 hours

Fixed overhead:
CU 1,500 / 7,500 hour

Variable overhead:
CU 2,700 / 3,000 hour

CU 4,200 / 3,000 hours

That's right!

The entity should allocate overhead costs to units produced at a rate of:

Fixed overhead: CU 1,500 / 7,500 hour = 0.2 CU/hour, that is fixed production overhead/labour hours for normal capacity.
Variable overhead: CU 2,700 / 3,000 hour = 0.9 CU/hour, that is variable production overhead/actual hours.

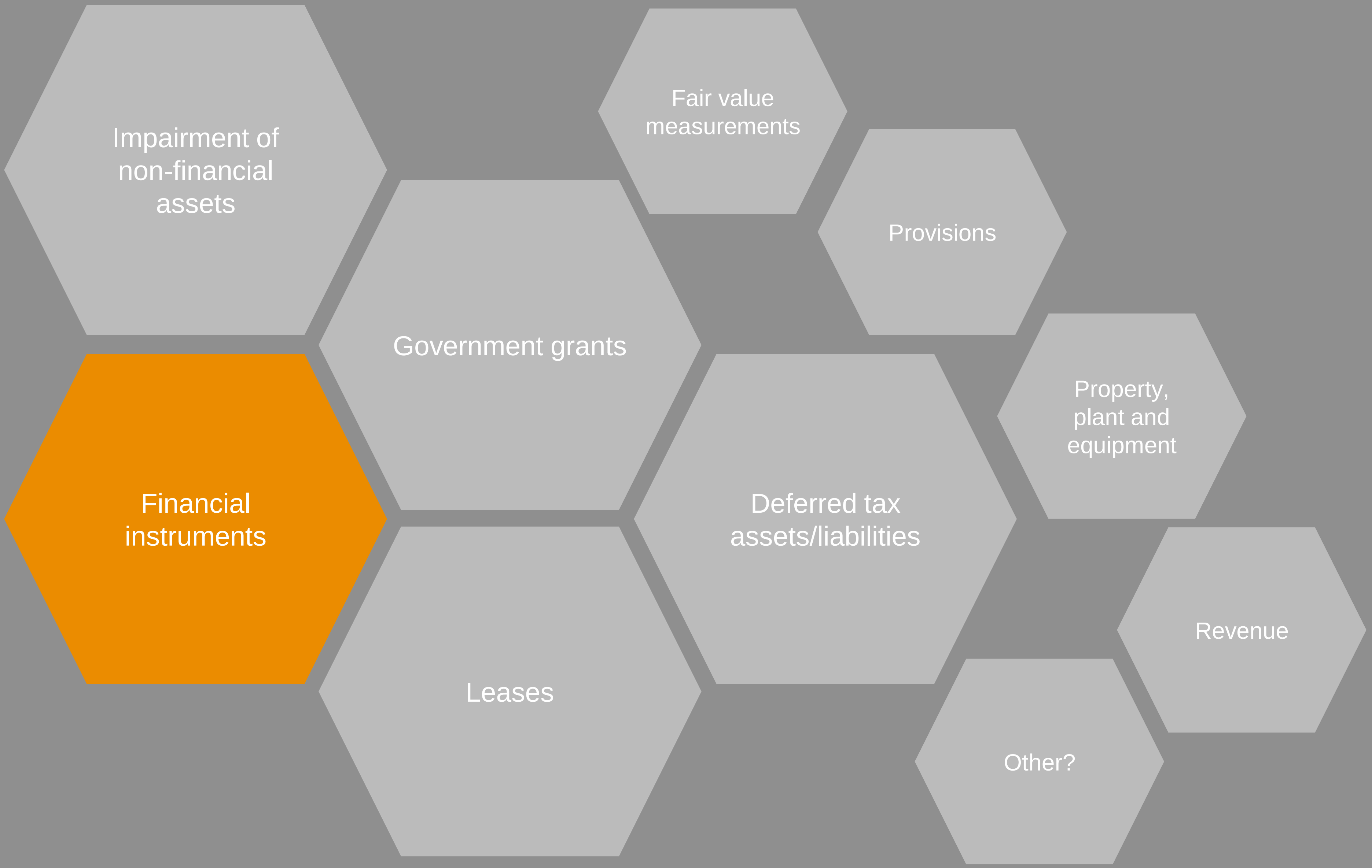
Fixed production overhead allocated to 3,000 units produced during the quarter (one unit per hour) = 3,000 × CU 0.2 = CU 600.

The remaining CU 900 (CU 1,500 – CU 600) of overhead incurred shall be recognised as an expense in profit or loss, because according to IAS 2 fixed production overheads are included in the cost of inventory based on normal production capacity.

Measurement and recognition issues

This seminar will cover measurement and recognition issues of the following items:

Please note, that this is not an exhaustive list of all the possible accounting implications. Each entity needs to analyze its own conditions and circumstances and, based on that assessment, should decide on the correct accounting treatment.

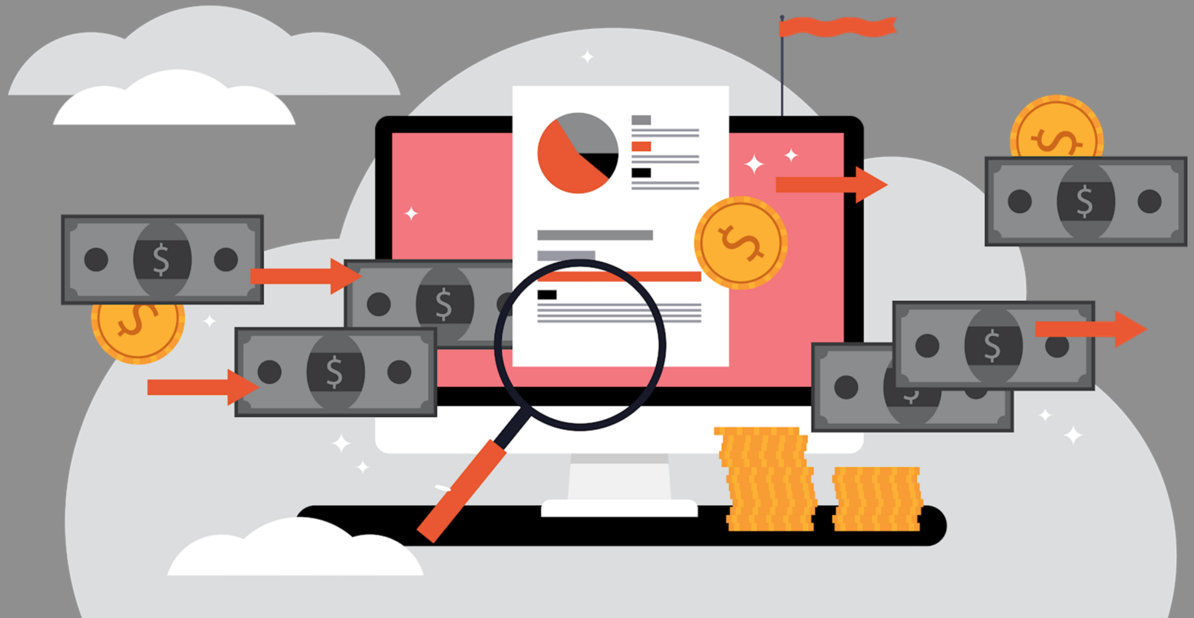


Financial instruments

Expected credit loss

Measurement

Hedge accounting



Financial instruments - Impairment

For financial instruments, several accounting topics are impacted: impairment; fair value measurement; modification/derecognition; and hedge accounting.

IFRS 9's expected credit loss (ECL) model

ECL is a 3-stage model. It classifies all instruments in its scope **into 3 different stages** based on the instrument's credit risk at the reporting date, by assessing whether there has been **a significant increase in credit risk (SICR) since initial recognition** of the instrument.

Instruments to be considered include loans, trade and other receivables, debt instruments measured at amortised cost, debt instruments measured at fair value through other comprehensive income, contract assets, lease receivables, financial guarantees and loan commitments.

Changes in credit risk since initial recognition

Stage 1 Performing	Stage 2 Underperforming	Stage 3 Non-performing
12-month ECL	Lifetime ECL	Lifetime ECL, PD = 1
Interest revenue: based on gross carrying amount	Interest revenue: based on gross carrying amount	Interest revenue: based on amortised cost

If there is a significant increase in credit risk since initial recognition, financial asset moves to Stage 2.

If financial asset becomes credit impaired, it moves to Stage 3.

Please note that in the case of assets subject to the **simplified approach**, such as short term receivables and contract assets, ECL is measured using lifetime ECL.

Financial instruments - Impairment

What are the possible effects of COVID-19?

The impacts of COVID-19 mean it is highly probable that some instruments' credit risk will increase, and forward looking macroeconomic information will worsen.

As a result management should consider:

- **which stage is appropriate** for particular instruments (whether there is a significant increase in credit risk)
- the **appropriate calculation** of ECL, including PD, LGD, EAD. (See their definition on the right.) A challenging question is which reasonable and supportable forward looking information about macroeconomic scenarios is relevant?

Because of the time value of money, even when a borrower is expected to repay all amounts owed but later than contractually required, there may be a credit loss.

Changes in credit risk since initial recognition

Stage 1 Performing	Stage 2 Underperforming	Stage 3 Non-performing
12-month ECL	Lifetime ECL	Lifetime ECL, PD = 1
Interest revenue: based on gross carrying amount	Interest revenue: based on gross carrying amount	Interest revenue: based on amortised cost

ECL = PD x LGD x EAD

PD – probability of default, LGD – loss given default, EAD – exposure at default

PD - **Risk of default** (credit risk): this may increase if the debtor's business is adversely impacted

LGD - the **estimated loss as a result of default**: this may increase if COVID-19 results in a decrease in the fair value of a non-financial asset pledged as collateral.

EAD - **the total amount at risk** if the debtor defaults: debtors affected by COVID-19 may draw down on unused borrowing facilities, or take longer than normal to pay, which results in a greater amount at risk.

Financial instruments - Impairment

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In assessing SICR, it is important to distinguish between: deterioration in credit risk over the expected life of a financial asset (indicator for Stage 2 or 3); and temporary liquidity issues of debtors, but whose lifetime credit risk may not have increased significantly (asset may remain in Stage 1).

Changes in credit risk since initial recognition

Stage 1 Performing	Stage 2 Underperforming	Stage 3 Non-performing
12-month ECL	Lifetime ECL	Lifetime ECL, PD = 1
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PD – pro … re at default

the debtor's bu adversely impa

e total amount at e debtor defaults: affected by COVID- draw down on borrowing facilities, onger than normal hich results in a mount at risk.

In some groups subsidiaries are not permitted to sell to particular customers unless credit insurance or a letter of credit is in place. Even where entities can take the **financial guarantee** or credit insurance into account, they should remember that this **can only reduce the risk of loss** (LGD) - it does not reduce the likelihood of default (PD) - and so will only impact measurement and not staging. Management should also consider whether the party providing the guarantee or insurance is likely to be able to meet its obligations when called upon.

Financial instruments - Impairment

IFRS 9 requires **forward-looking information** (including macro-economic information) is considered both when assessing whether there has been a significant increase in credit risk and when measuring expected credit losses.

Please be aware that when incorporating forward looking information, such as macroeconomic forecasts, into the determination of ECLs an entity should **consider the relevance of the information for each specific financial instrument or group** of financial instruments. This is because forward-looking information that is relevant for one financial instrument, may not be relevant, or as relevant, for other financial instruments depending on the specific drivers of credit risk.

Where information is not available on individual instrument level, a **collective assessment** should be used: “top-down” approach to identify business sectors, regions, groups of borrowers that are most vulnerable and apply a collective overlay adjustment.

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Why forward-looking information?

An entity cannot rely solely on **delinquency (i.e. past due) information** when estimating ECLs; it also needs to consider **reasonably available forward-looking information**.

Historical data (such as historical loss rate) could be used as a base from which to measure ECL. But such data should be adjusted to reflect current conditions and forecasts of future conditions that did not affect the period on which the historical data is based, and to remove the effects of the conditions in the historical period that are not relevant to the future contractual cash flows. Estimates of changes in ECL should reflect, and be directionally consistent with, changes in related observable data from period to period.

What forward-looking information to consider?

To be able to answer this question, you should understand actually what drives the level of default for particular debtors. Consideration should be given to the impact of expected changes in the economic, regulatory and technological environment, and external market indicators (such as industry outlook, GDP, unemployment, politics).

If for example, there is a historical correlation between unemployment rates and the loss rate, an economic downturn and increase in unemployment rates is expected to lead to increased losses. Other forward-looking information could be: property prices, commodity prices, interest rates, inflation index and other economies forecasts.

Financial instruments - Impairment

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Where information is not available on individual instrument level, a **collective assessment** should be used: "top-down" approach to identify business sectors, regions, groups of borrowers that are most vulnerable and apply a collective overlay adjustment.

An entity can group financial instruments on the basis of shared credit risk characteristics.

Examples of shared credit risk characteristics are:

- instrument type
- credit risk ratings
- collateral type
- date of initial recognition
- remaining term to maturity
- industry
- geographical location of the borrower and
- value of collateral relative to the financial asset.

What do you think…?

How can an entity apply the potential additional downside scenarios into its ECL model as a result of COVID-19?

By adding one or more additional scenarios to the entity's existing scenarios.

By amending one or more of the existing scenarios (for example, to reflect a more severe downside(s) and/or to increase their weighting).

By using an 'overlay' if the impact is not included in the entity's main expected credit loss model.

All of these approaches are possible.

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All of these approaches are possible.

Financial instruments - Impairment - Test your understanding!

If governments ask local banks to support borrowers in the form of payment holidays on all existing loans in a certain class (e.g. all loans to small businesses), what are the potential impacts on the lender's financial statements regarding ECL?

Payment holidays may indicate the affected loans have suffered a significant increase in credit risk or even a default, and therefore may be moved to stage 2 or 3 of the ECL model (but it's not immediately presumable for all loans).

Providing payment holidays on loans automatically means that loans have suffered a significant increase in credit risk and therefore shall be moved to stage 2.

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That's right!

Guarantees and collateral provided to lenders on loans generally reduce the loss on a default, so are included in measuring the expected credit loss amount and also affect staging (that is whether the loan is in stage 1 vs stage 2 or 3).

Is this statement correct?

Yes

No

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Is this statement correct?

Yes

No

That's right!

Guarantees, collateral and similar credit enhancements provided to borrowers on loans generally reduce the loss on a default and so are included in measuring ECL amount, **but not the risk of default**, so do not affect staging.

KEY REMINDERS

1 Although a high level of judgement is required in determining which forward-looking information is reasonable and supportable and how it impacts ECL measurement in an economic downturn as a result of COVID-19, it **should still be possible to make an assessment.**

2 Changes in ECL should be **directionally consistent** with changes in related observable data, such as unemployment rates, property prices, commodity prices, payment status. But it is also appropriate to consider expected impact of government support measures (if any).

3 ECL estimate reflects **probability-weighted** outcomes, so it is not appropriate to exclude an event because:

- it has low probability of occurring; or
- its effect on credit risk and ECL estimate is uncertain.

4 For staging (i.e. whether an instrument is in stage 1 vs stage 2 or 3), entities should **distinguish between** short-term liquidity issue (may not indicate SICR) vs longer term credit deterioration (SICR indicator).

KEY REMINDERS

5 **Moratoria on payments extended to all loans of a particular type** (e.g. all mortgage loans or all loans to small entities) and similar blanket measures do not mean that all instruments have experienced SICR because they do not discriminate between borrowers.

6 **Guarantees, collateral and similar credit enhancements** provided to borrowers on new loans generally reduce the loss on a default (and so are included in measuring ECL amount) but not the risk of default (so do not affect staging).

7 Guarantees, collateral and similar credit enhancements provided to borrowers generally reduce the loss on a default, but there is a need to **reassess the guarantor's** ability to pay and the **value of collateral**.

8 Governments may provide different **government relief programmes** to the borrower and/or to the lender.

- If government reliefs are given **to the borrower/debtor**, it may affect **staging** (assessment of whether there is a significant increase in credit risk since initial recognition of the instrument) **and ECL measurement**.
- If government reliefs are given to the **lender** to compensate for a loss on a default, it affects **only ECL measurement** and not staging.

Financial instruments – ESMA's and EBA's view

Many regulators in different jurisdictions have commented on their expectations of how COVID-19 should be taken into account for ECL. The guidance issued in March 2020 by ESMA (European Securities and Markets Authority) is similar to that issued by other regulators and is consistent with the requirements of IFRS 9.

Main aspects of ESMA's public statement

In ESMA's view, the principles-based nature of IFRS 9 includes sufficient flexibility to faithfully reflect the specific circumstances of the COVID-19 outbreak and the associated public policy measures.

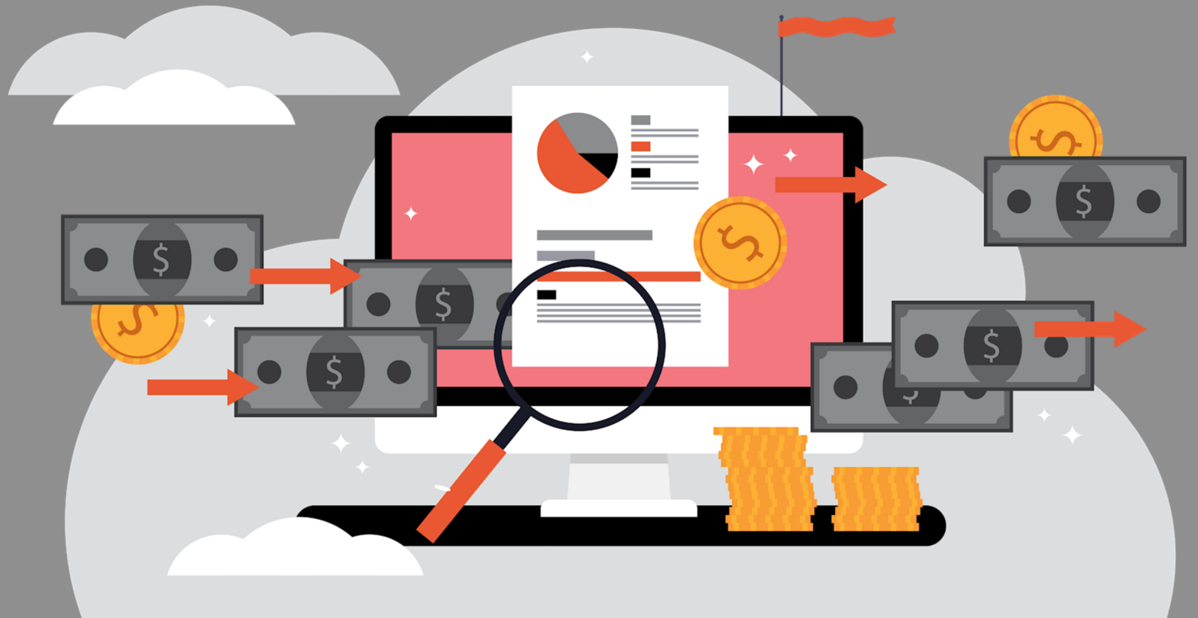
1. Assessment of significant increase in credit risk (SICR)
2. ECL estimation (impact of high degree of uncertainty and nature of economic shock)
3. Public guarantee on exposures
4. Result of support measures: modification or derecognition
5. Transparent disclosures

Financial instruments

Expected credit loss

Measurement

Hedge accounting



Financial instruments – Measurement

Initial measurement

What is the fair value?
Reduced fees or interest rates on new loans might indicate that the loans were not issued at a market rate.

Modification or derecognition?
To mitigate the impact of COVID-19 banks might agree to changes to the contractual cash flows.
Both parties – borrower and lender – should apply the guidance in IFRS 9 to determine whether the change to the terms results in derecognition and, if not, to recognise a modification gain or loss.

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Both parties – borrower and lender – should apply the guidance in IFRS 9 to determine whether the change to the terms results in derecognition and, if not, to recognise a modification gain or loss.

IFRS 9 has different **derecognition criteria** for financial assets and financial liabilities.

An entity shall remove **a financial liability** (or a part of a financial liability) from its statement of financial position when, and only when, it is extinguished- i.e. when the obligation specified in the contract is discharged or cancelled or expires. In the case of financial liabilities for determining if the terms of the contract have been **substantially modified,** an entity has an **accounting policy choice**:

- either it can apply the quantitative 10% test,
- or, even if the 10% test is passed, it could choose to also perform a qualitative assessment for de-recognition (e.g. change of the currency, change of interest rate from fixed to variable, etc.).

The derecognition of a **financial asset** is assessed through a **derecognition tree** consisting of nine consecutive steps, which focus on whether all risks and rewards are substantially transferred, and whether control is retained. In the case of financial assets, there is no mandatory quantitative threshold of 10% for modification assessment. What qualitative factors should be considered?

If **derecognition does not apply**, an entity must discount the modified contractual cash flows by the original effective interest rate of the financial instrument, and the difference shall be recognised immediately in profit or loss as **modification gain or loss.**

Financial instruments - Measurement

As a response to the impact of COVID-19 on entities, different **payment holidays** on loans are put in place, some are imposed by law or based on government recommendation with amendments being made to the agreements. In other cases, the agreements are amended. **What are the accounting implications of these measures?**

Revision of expected cash flows

Assumptions:
Blanket holidays imposed by law and effective automatically without amendments being made to loan agreements. Individual borrowers may opt out by application.

Contractual modification

Assumptions:
In response to recommendation by a government, individual borrowers approach banks and apply for payment holidays. Granting of holidays results in amending the individual loan agreements (borrowers have to 'opt in' and banks have a degree of discretion).

Financial instruments - Measurement

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Revision of expected cash flows

Assumptions:
Blanket holidays imposed by law and effective automatically without amendments being made to loan agreements. Individual borrowers may opt out by application.

Solution (with no extinguishment)
In this case the borrower should revise the expected gross carrying amount by discounting the rescheduled payments at original effective interest rate. If the 10% threshold is not met (ie, modification) ,the liabilities is adjusted and the resulting gain is recognised immediately in profit or loss

Contractual modification

Assumptions:
In response to recommendation by a government, individual borrowers approach banks and apply for payment holidays. Granting of holidays results in amending the individual loan agreements (borrowers have to ‘opt in’ and banks have a degree of discretion).

Solution (with extinguishment)
In this case the borrower should recalculate the expected gross carrying amount by discounting the rescheduled payments at original effective interest rate. If the 10% threshold is met (ie, extinguishment) the old liabilities is derecognised and a new libaility is recognised at fair value with a new effective interest rate. The resulting gain is recognised immediately in profit or loss

Financial instruments - Measurement

Let's take a look at an example of modification of the cash flows imposed by law (assume the change is not significant enough to lead to derecognition).

On 1 January 20X1, A originates a 5-year 4.7% CU 1,250 loan. The loan carries an annual interest rate of 4.7% (CU 59) payable at the end of each year, and is repayable at par at the end of year 5. Entity A charges CU 250 non-refundable loan origination fee to the borrower.

The initial carrying amount of the loan payable is: 1,250 (principal) – 250 (origination fee charged to the borrower) = 1,000.

The discount rate necessary to equate 5 annual payments of 59 and a final payment at maturity of 1,250 to the initial carrying amount of 1,000 is approximately 10% (effective interest rate).

Table 1 shows the carrying amount calculation of the loan.

On 1 January 20X3 as a result of blanket payment holidays imposed by the government in order to mitigate negative effects of economic circumstances, the cash flows are changed, so that no amount is due during 20X3, and the maturity is prolonged by one year. The adjusted cash flows are shown in Table 2.

How is the change in estimated cash flows to be accounted for?

Table 1	Opening balance	**Cash outflows**	Interest expense (10%)	**Carrying amount**
20X1	1,000	-59	100	1,041
20X2	1,041	-59	104	1,086
20X3	1,086	-59	108	1,136
20X4	1,136	-59	113	1,190
20X5	1,190	-59-1,250	119	0
Total		1,544	544	

Table 2	Principal	Interest	Total cash flow
20X3	0	0	0
20X4	0	59	59
20X5	0	59	59
20X6	1,250	59	1,309
Total			

Financial instruments - Measurement

1,250 x 4.7% = 59

1,000 x 10% = 100

1,041 x 10% = 104

1,000 – 59 + 100 = 1,041

59 / $1,1^2$ = 49

59 / $1,1^3$ = 44

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20X4	1,136	-59	113	1,190
20X5	1,190	-59-1,250	119	0
Total		1,544	544	

Table 2	Principal	Interest	Total cash flow	Present value (original EIR 10%)
20X3	0	0	0	0
20X4	0	59	59	49
20X5	0	59	59	44
20X6	1,250	59	1,309	895
Total				988

1 Jan 20X3 Opening amortised carrying amount before change in cash flows	1,086
1 Jan 20X3 Adjusted amortised carrying amount	988
Adjustment for the gain recognized in profit or loss	**98**

As such, the carrying amount should be adjusted (from 1,086 to 988) to reflect the new cash flows, discounted using the original effective interest rate of 10%.

The adjustment of CU 98 is recognised in profit or loss in 20X3.

Initial measurement

What is the fair value?
Reduced fees or interest rates on new loans might indicate that the loans were not issued at a market rate.

The initial measurement of financial instruments is always at fair value + or – transaction costs (if not measured at fair value through profit or loss).

What is the fair value?
According to IFRS 9, the fair value of a financial instrument will normally be the **transaction price**. However, if part of the consideration is for something other than the financial instrument, the fair value shall be measured, and any additional amounts is an expense or reduction of income.

If the **fair value of the financial instrument differs from the transaction price**:

- the difference is recognised as a gain or loss only if fair value is evidenced by a quoted price in an active market for an identical asset or liability (that is, a level 1 input) or based on a valuation technique that uses only data from observable markets.
- in all other cases, an entity recognises the instrument at fair value and defers the difference between the fair value at initial recognition and the transaction price.

Targeted government programs where banks obtain low interest funding and / or provide low interest loans to specific borrowers require analysis based on **specific facts and circumstances to determine whether there is a government grant to account for.**

- Is the arrangement provided on market terms?
- If the arrangement is not provided on market terms, is there an element of government grant?
- If so, who is the beneficiary of the government grant?
- What is the accounting by the beneficiary of the government grant?
- What is the accounting if the transaction is not provided on market terms but there is no government grant?

Financial instruments - Measurement - Test your understanding!

What happens on the lender side?

As a result of COVID-19, to mitigate the negative impact of the pandemic, blanket payment holidays are imposed by law and effective automatically without amendments being made to loan agreements. If individual customers do not want to use these payment holidays, they may opt out by application.

Bank should revise the expected gross carrying amount by discounting the rescheduled payments at original effective interest rate.

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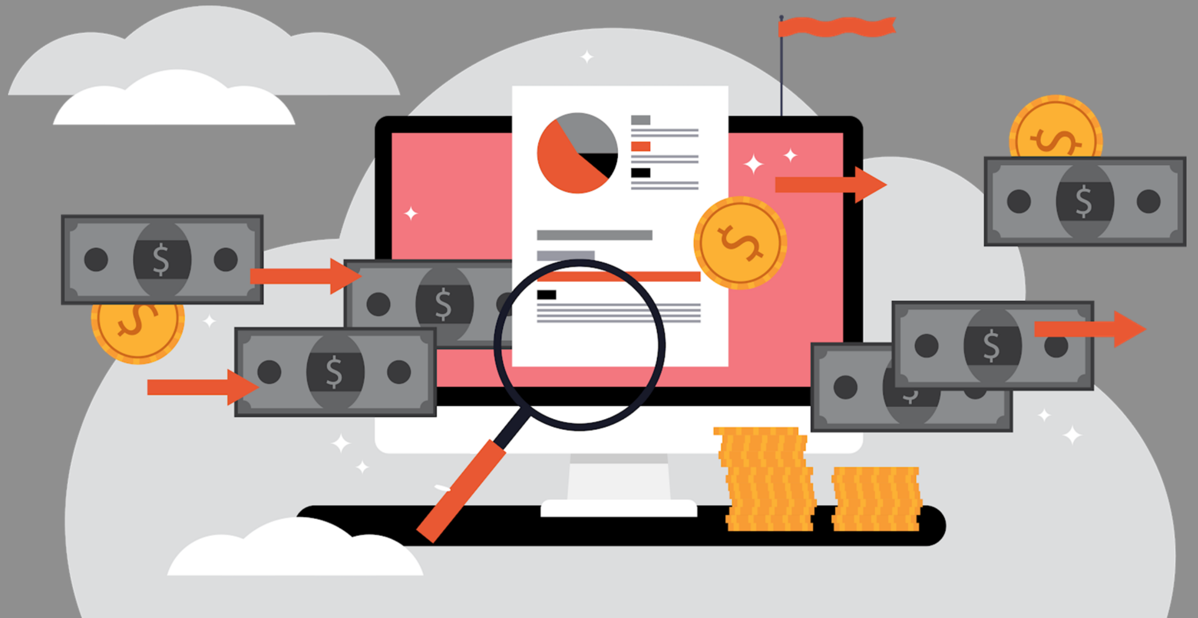
In this example of a payment holiday, bank should revise the expected gross carrying amount of the loans by discounting the rescheduled payments at original effective interest rate and the resulting loss is recognised immediately in profit or loss as a cumulative catch-up adjustment.

Financial instruments



Expected credit loss

Measurement

Hedge accounting

Have the criteria of hedge accounting been met?

COVID-19 can impact hedge accounting as well. Due to economic changes, such as significant volatility in market prices, foreign exchange rates, interest rates, etc., **new risk exposures** could arise, against which companies may want to apply hedge accounting.

For existing hedge relationships a question arises, whether the entity continues to **meet the criteria for hedge accounting**. If not, the hedge relationship should be discontinued.

IFRS 9 provides an **accounting policy choice**: entities can either continue to apply the hedge accounting requirements of IAS 39, pending the macro hedging project being finalised, or they can apply IFRS 9.

If IFRS 9 is applied, it can be applied either in its entirety, or with the exception of the guidance for fair value macro hedges of interest rate risk. This accounting policy choice will apply to all hedge accounting and cannot be made on a hedge-by-hedge basis. An entity that has chosen to continue to apply IAS 39 can change its policy to apply IFRS 9 at the beginning of any reporting period.

According to IFRS 9 an entity is only allowed to apply hedge accounting if it meets **the specified qualifying criteria**, which are as follows:

- The hedging relationship consists only of eligible hedging instruments and eligible hedged items.
- There is formal designation and documentation of the hedging relationship and risk management objective and strategy at inception of the hedge.
- The hedge relationship meets the hedge effectiveness requirements.

According to IFRS 9 voluntary de-designation of hedge accounting is prohibited. Hedge accounting should be discontinued prospectively only when the hedging relationship (or part of the relationship) ceases to meet the qualifying criteria for hedge accounting.

What would be an example of no longer meeting the qualifying criteria under IFRS 9?
Choose the correct answer!

A. The hedging instrument expires or is sold, terminated or exercised.
B. The hedged item is sold, extinguished or no longer expected to occur.
C. The hedging relationship no longer meets the risk management objective.
D. The hedge effectiveness requirements are not met (for example, there is no longer an economic relationship between the hedged item and the hedging instrument, or the effect of credit risk starts to dominate the value changes that result from that economic relationship).
E. All of the above are correct.

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D. The hedge effectiveness requirements are not met (for example, there is no longer an economic relationship between the hedged item and the hedging instrument, or the effect of credit risk starts to dominate the value changes that result from that economic relationship).
E. All of the above are correct.

Hedge relationships might be significantly impacted by either changes in the timing of the cash flows of the underlying instruments or changes in the probability of a forecast transaction:

Revision of expected cash flows

For example a payment holiday might create an impact on hedging relationships. Although an entity might consider that the original hedged loan remains outstanding, its cash flows no longer perfectly match the hedging instrument.

The payment holiday results in a mismatch in the timing of cash flows between the hedged item and the hedging instrument. This mismatch in the timing of the cash flows would likely not be significant enough to violate the economic relationship effectiveness test, but it **would result in some ineffectiveness being recognised in profit or loss.**

Change in probability of a forecast transaction

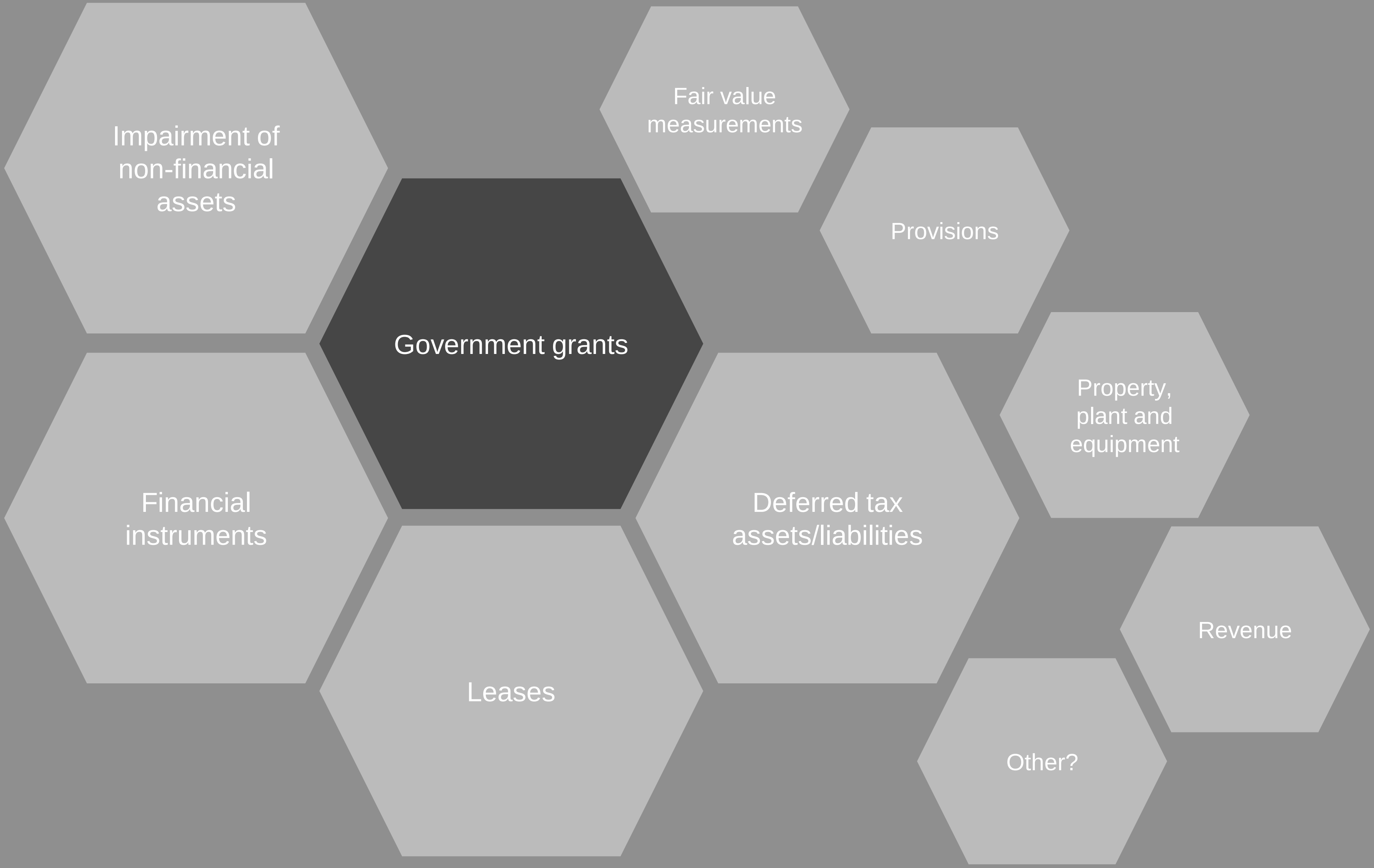
As a result of COVID-19, besides hedge effectiveness issues, another problem could arise from the eligibility of hedged items, for example a transaction that was considered highly probable might be canceled from a supplier/customer.

Why? Because a hedged item can be a highly probable forecast transaction. Highly probable refers to significantly higher probability than ‘more likely than not’. As an outcome of the eligibility assessment of a hedged item, a hedging relationship **would be discontinued if a forecast transaction is no longer highly probable**.

Measurement and recognition issues

This seminar will cover measurement and recognition issues of the following items:

Please note, that this is not an exhaustive list of all the possible accounting implications. Each entity needs to analyze its own conditions and circumstances and, based on that assessment, should decide on the correct accounting treatment.



Government grants

In response to the measures taken to control the spread of COVID-19, **governments are providing reliefs** to lessors, employers, financial institutions and other entities.

Accounting treatment of government grants is regulated by IAS 20.

According to IAS 20 - *Accounting for Government Grants and Disclosure of Government Assistance*, **government grants** are:

assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity.

Grants given by local, national and international government, including inter-governmental agencies and similar bodies, are within the scope of IAS 20.

When should government grants be recognised?

Government grants

In response to the measures taken to control the spread of COVID-19, **governments are providing reliefs** to lessors, employers, financial institutions and other entities.

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Grants given by local, national and international government, including inter-governmental agencies and similar bodies, are within the scope of IAS 20.

When should government grants be recognised?

Government grants should be recognised if it there is **reasonable assurance** that:

- the entity will comply with the conditions attaching to them AND
- the grants will be received.

What is reasonable assurance?
Reasonable assurance is not defined in IAS 20, and significant judgment is therefore required when the recognition criteria under IAS 20 are applied in practice.

Government grants

Government grants are recognised in the **income statement on a systematic basis** over the periods in which the related costs towards which they are intended to compensate are recognised as expenses.

Grants for specific expenses	in the same period as the relevant expense
Grants for depreciable assets	over the periods and in the proportions in which related expense is recognised

Types of government grants

Income related

Grants related to income are government grants other than those related to assets, for example grant related to percentage of the payroll cost or a fixed amount per job safeguarded.

The majority of government grants as a result of COVID-19 are income grants because they are intended to compensate an entity for expenses incurred as a result of COVID-19.

Asset related

Grants related to assets are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets.

Presentation of grants related to income

Regarding the presentation of grants related to income entities can choose between net and gross presentation.

The presentation approach is an accounting policy choice and should be applied consistently to all similar grants.

Where can an entity present an income related grant?

Gross presentation	OR	Net presentation
Income related grants can be presented as a **credit in the income statement**.		Alternatively income related grants can be **deducted from the related expense**.
Dr Cash or Receivable Cr Deferred income Dr Deferred income **Cr Income** (separate line or other income)		Dr Cash or Receivable Cr Deferred income Dr Deferred income **Cr Expense**

Presentation of grants related to income

Regarding the presentation of grants related to income entities can choose between net and gross presentation.

The presentation approach is an accounting policy choice and should be applied consistently to all similar grants.

Where can an entity present an income related grant?

Where can an entity present an income related grant?

The presentation alternatives are the following:

- **generally other income (outside revenue):** An entity might present these grants as ‘other income’ outside revenue within operating profit, where income from other government grants is presented when the gross approach is followed.
- **in rare cases, other revenue:** Although government grants do not meet the definition of either revenue from contracts with customers or lease income, in rare situations an entity might view the grant as meeting the broader definition of revenue and therefore being presented as part of total revenue.

  This can be acceptable if the entity is entitled to the grant **as a result of the loss of revenue** from providing its goods/services in the ordinary course of business. If the grant is presented as part of total revenue, it should be presented separately from revenue from contracts with customers (scope of IFRS 15) and lease revenue (scope of IFRS 16). This separate presentation would be achieved by disaggregating the different components of total revenue.

How to account for government relief programs as a result of COVID-19?

1. Determine **whether** the relief received is a **government grant** based on the definition and scope of IAS 20. In some cases, the grant might relate to income taxes in the scope of IAS 12 and therefore scoped out of IAS 20. In other cases, governments are providing broad-based relief in an effort to support their economies more generally from the negative impacts of COVID-19. In some cases, this broad-based relief does not meet the definition of a government grant, for example, some loans are lower than previously provided, but this is as a result of the current economic environment rather than specific government assistance.

2. Determine **whether the entity receives** a government grant, **or facilitates** the transferring of relief to the end party on behalf of the government. In some cases, the entity merely acts as a conduit to provide relief from the government to employees, lessees or borrowers and therefore the entity is not the recipient of the government grant. To make this determination, an entity considers whether it **controls** the grant before it transfers to the end recipient.

3. Consider **when** the entity that receives a grant meets the **"reasonable assurance"** criteria, ie the entity has reasonable assurance that:
   - the entity will comply with any conditions attaching to the grant; and
   - the grant will be received.

4. Identify **what expense or economic loss** the grant is intended to **compensate for** and consider how that expense or economic loss is recognised based on the applicable IFRS standard (e.g. IFRS 16 for lessors or IAS 19 for employers).

5. **Recognise the grant in profit or loss** in a manner that **matches the pattern** of recognition for the related expense or economic loss.

6. Consider the **presentation** of the grant income (whether the grant is presented gross or net of the related expenditure in accordance with the accounting policy choice in IAS 20).

Let’s apply the steps using an example!

A government has introduced a scheme into law that provides a cash rebate, for example in the form of a property tax rebate, to commercial lessors. The rebate has the following features:

- The rebate has an explicit requirement that it is passed on to the lessees to compensate for the lessee’s not being able to pay rent as a result of COVID-19. Lessors will have an obligation to repay the grant to the government if they do not pass on the grant to the lessee.
- However, lessors have discretion over the proportion of the rebate allocated to individual lessees and the manner in which the rebate is passed on.

For example, for some leases, lessors might provide a fixed amount of rebate per month, whereas for other leases, lessors might provide a percentage rental reduction per month or make a single payment to the lessee. In some cases, the lessors may provide more relief to the lessees than the rebate received from the government. Lessors are also provided a “reasonable” amount of time to make these decisions once the cash rebate has been received.

How should the lessor account for the relief it receives from the government?

Step 1 +

Step 2 +

Step 3 +

Step 4 +

Step 5 +

Step 6 +

Let's apply the steps using an example!

A government has introduced a scheme into law that provides a cash rebate, for example in the form of a property tax rebate, to commercial lessors. The rebate has the following features:

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- However, lessors have discretion over the proportion of the rebate allocated to individual lessees and the manner in which the rebate is passed on.

For example, for some leases, lessors might provide a fixed amount of rebate per month, whereas for other leases, lessors might provide a percentage rental reduction per month or make a single payment to the lessee. In some cases, the lessors may provide more relief to the lessees than the rebate received from the government. Lessors are also provided a "reasonable" amount of time to make these decisions once the cash rebate has been received.

How should the lessor account for the relief it receives from the government?

Step 1: Determine **whether** the relief received is a **government grant** based on the definition and scope of IAS 20

Yes, it is a government grant.
The relief meets the definition of a government grant, because it is specific government assistance in the form of a transfer of resources to commercial lessors in return for compliance with certain conditions relating to the operating activities of the lessors.

Step 2

Step 3

Step 4

Step 5

Step 6

Let's apply the steps using an example!

A government has introduced a scheme into law that provides a cash rebate, for example in the form of a property tax rebate, to commercial lessors. The rebate has the following features:

- The rebate has an explicit requirement that it is passed on to the lessees to compensate for the lessee's not being able to pay rent as a result of COVID-19. Lessors will have an obligation to repay the grant to the government if they do not pass on the grant to the lessee.
- However, lessors have **discretion over the proportion** of the rebate allocated to **individual lessees** and the **manner** in which the rebate is passed on.

For example, for some leases, lessors might provide a fixed amount of rebate per month, whereas for other leases, lessors might provide a percentage rental reduction per month or make a single payment to the lessee. In some cases, the lessors may provide more relief to the lessees than the rebate received from the government. Lessors are also provided a **"reasonable" amount of time** to make these decisions once the cash rebate has been received.

How should the lessor account for the relief it receives from the government?

Step 1 **Yes, it is a government grant.** +

Step 2: Determine **whether the entity receives** a government grant, **or facilitates** the transferring of relief to the end party on behalf of the government. +

The entity receives the grant.
The lessor is the party that receives the relief because it controls the grant before it transfers to the lessee:

- it can direct which lessees receive and
- in what proportions the relief is distributed,
- as well as the manner in which the relief is provided.

Lessors also have a reasonable amount of time to determine when the grant must be distributed.

Step 3 +

Step 4 +

Step 5 +

Step 6 +

Let’s apply the steps using an example!

A government **has introduced a scheme into law** that provides a cash rebate, for example in the form of a property tax rebate, to **commercial lessors**. The rebate has the following features:

- The rebate has an explicit requirement **that it is passed on to the lessees** to compensate for the lessee’s not being able to pay rent as a result of COVID-19. Lessors will have an obligation to repay the grant to the government if they do not pass on the grant to the lessee.
- However, lessors have discretion over the proportion of the rebate allocated to individual lessees and the manner in which the rebate is passed on.

For example, for some leases, lessors might provide a fixed amount of rebate per month, whereas for other leases, lessors might provide a percentage rental reduction per month or make a single payment to the lessee. In some cases, the lessors may provide more relief to the lessees than the rebate received from the government. Lessors are also provided a “reasonable” amount of time to make these decisions once the cash rebate has been received.

How should the lessor account for the relief it receives from the government?

Step 1 **Yes, it is a government grant.** +

Step 2 **The entity receives the grant.** +

Step 3: Consider **when** the entity that receives a grant meets the **"reasonable assurance"** criteria +

Requires judgement.
The government has introduced the scheme into law.
Lessors would need to consider whether there is reasonable assurance that:

- They would qualify for the scheme and be considered commercial lessors as defined in the legislation.
- They would comply with the scheme requirements to pass the relief on to their related lessees.

Step 4 +

Step 5 +

Step 6 +

Let's apply the steps using an example!

A government has introduced a scheme into law that provides a cash rebate, for example in the form of a property tax rebate, to commercial lessors. The rebate has the following features:

- The rebate has an explicit requirement that it is passed on to the lessees **to compensate for the lessee's not being able to pay rent as a result of COVID-19**. Lessors will have an obligation to repay the grant to the government if they do not pass on the grant to the lessee.
- However, lessors have discretion over the proportion of the rebate allocated to individual lessees and the manner in which the rebate is passed on.

For example, for some leases, lessors might provide a fixed amount of rebate per month, whereas for other leases, lessors might provide a percentage rental reduction per month or make a single payment to the lessee. In some cases, the lessors may provide more relief to the lessees than the rebate received from the government. Lessors are also provided a "reasonable" amount of time to make these decisions once the cash rebate has been received.

How should the lessor account for the relief it receives from the government?

Step 1 **Yes, it is a government grant.** +

Step 2 **The entity receives the grant.** +

Step 3 **Requires judgement.** +

Step 4: Identify **what expense or economic loss** the grant is intended to **compensate for** and consider how that expense or economic loss is recognised based on the applicable IFRS standard (e.g. IFRS 16 for lessors or IAS 19 for employers) +

The relief is intended to compensate for the reduction of lease income.
The lessor determines that the relief is intended to compensate for the reduction of lease income from the lessee. The lessor therefore considers the guidance in IFRS 16 to determine the recognition and measurement of the reduction in lease income. Please see the Leases section of this seminar for guidance on how a lessor might make this determination.

Step 5 +

Step 6 +

Let's apply the steps using an example!

A government has introduced a scheme into law that provides a cash rebate, for example in the form of a property tax rebate, to commercial lessors. The rebate has the following features:

- The rebate has an explicit requirement that it is passed on to the lessees to compensate for the lessee's not being able to pay rent as a result of COVID-19. Lessors will have an obligation to repay the grant to the government if they do not pass on the grant to the lessee.
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How should the lessor account for the relief it receives from the government?

Step 1 **Yes, it is a government grant.**

Step 2 **The entity receives the grant.**

Step 3 **Requires judgement.**

Step 4 **The relief is intended to compensate for the reduction of lease income.**

Step 5: **Recognise the grant in profit or loss** in a manner that **matches the pattern** of recognition for the related expense or economic loss

Relief is recognised over the period of reduced lease income.
The relief should be recognised in profit or loss over the periods in which the lessor recognises as expenses the related costs for which the relief was intended to compensate.
The reduction of the lease income from the lessee is equivalent to an expense and therefore the relief is recognised over the period of reduced lease income.

Step 6

Let’s apply the steps using an example!

A government has introduced a scheme into law that provides a cash rebate, for example in the form of a property tax rebate, to commercial lessors. The rebate has the following features:

- The rebate has an explicit requirement that it is passed on to the lessees to compensate for the lessee’s not being able to pay rent as a result of COVID-19. Lessors will have an obligation to repay the grant to the government if they do not pass on the grant to the lessee.
- However, lessors have discretion over the proportion of the rebate allocated to individual lessees and the manner in which the rebate is passed on.

For example, for some leases, lessors might provide a fixed amount of rebate per month, whereas for other leases, lessors might provide a percentage rental reduction per month or make a single payment to the lessee. In some cases, the lessors may provide more relief to the lessees than the rebate received from the government. Lessors are also provided a “reasonable” amount of time to make these decisions once the cash rebate has been received.

How should the lessor account for the relief it receives from the government?

Step 1 **Yes, it is a government grant.**

Step 2 **The entity receives the grant.**

Step 3 **Requires judgement.**

Step 4 **The relief is intended to compensate for the reduction of lease income.**

Step 5 **Relief is recognised over the period of reduced lease income.**

Step 6: Consider the **presentation** of the grant income (whether the grant is presented gross or net of the related expenditure in accordance with the accounting policy choice in IAS 20). In this example, there is no recognised expense, rather, the lessor suffers a reduction in lease revenue. Therefore there is no need to consider whether to present this grant on a gross or net basis, ie it will be gross.

In this specific example, the lessor might need to consider whether present the grant as “other revenue” or “other income”.

Let's apply the steps using an example!

A government has introduced a scheme into law that provides a cash rebate, for example in the form of a property tax rebate, to commercial lessors. The rebate has the following features:

- The rebate has an explicit requirement that it is passed on to the lessees to compensate for the lessee's not being able to pay rent as a result of COVID-19. Lessors will have an obligation to repay the grant to the government if they do not pass on the grant to the lessee.
- However, lessors have discretion over the proportion of the rebate allocated to individual lessees and the manner in which the rebate is passed on.

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How should the lessor account for the relief it receives from the government?

Step 1 **Yes, it is a government grant.** +

Step 2 **The entity receives the grant.** +

Step 3 **Requires judgement.** +

Step 4 **The relief is intended to compensate for the reduction of lease income.** +

Step 5 **Relief is recognised over the period of reduced lease income.** +

Step 6 **Presentation as other income or other revenue.** +

Government grants – Test your understanding

The government introduces a scheme in which selected employees are allowed to apply online for government relief provided they meet certain criteria. This relief is then paid to the employees by the government via their employer.

The employer does not have any discretion about which employees receive the grant or how much is granted. The employer is legally bound to pass on the cash to the employee within seven days of receipt of the related relief payment.

Does the employer have to recognise the government grant?

Yes

No

Government grants – Test your understanding

The government introduces a scheme in which selected employees are allowed to apply online for government relief provided they meet certain criteria. This relief is then paid to the employees by the government via their employer.

The employer does not have any discretion about which employees receive the grant or how much is granted. The employer is legally bound to pass on the cash to the employee within seven days of receipt of the related relief payment.

Does the employer have to recognise the government grant?

Yes

No

The employer is not the recipient of the grant, because it does not control the cash relief and it does not have the present ability to direct the use of the cash to obtain benefits.

The employer has no discretion over the timing, amount or manner in which the grant is distributed to employees.

The employer might still need to recognise the cash asset and related liability to employees to the extent that the cash has been received but not yet distributed at a reporting period end.

Measurement and recognition issues

This seminar will cover measurement and recognition issues of the following items:

Please note, that this is not an exhaustive list of all the possible accounting implications. Each entity needs to analyze its own conditions and circumstances and, based on that assessment, should decide on the correct accounting treatment.

- Impairment of non-financial assets
- Fair value measurements
- Provisions
- Government grants
- Property, plant and equipment
- Financial instruments
- Deferred tax assets/liabilities
- Leases
- Revenue
- Other?

Leases

As a result of COVID-19, a lessor and a lessee might renegotiate the terms of a lease or a lessor might grant a lessee a concession of some sort in connection with lease payments. In some cases, a lessor might receive compensation from a local government as an incentive to offer such concessions. **Is it a modification of a lease agreement?** Is this an immediate gain in profit or loss or adjustment to right-of-use asset in lessee's books?

Both lessors and lessees should consider the requirements of IFRS 16 - *Leases* and whether the concession should be accounted for as variable lease payments, lease modification or something else.

Leases

Concessions that have been granted to lessees as a result of COVID-19 might take a variety of forms, including payment holidays, cash rebates and deferral of lease payments.

Should these concessions be treated:

- as (negative) variable lease payments,
- forgiveness of some of the lease payments,
- deferral of some of the lease payments, or
- a lease modification depending on the facts and circumstances?

In May 2020 the IASB issued amendments to IFRS 16, the *COVID-19-Related Rent Concessions* amendment, which provides lessees with an **optional exemption** from assessing whether a COVID-19-related rent concession is a lease modification. This exemption is provided **only for lessees**!

Lessors and lessees should also consider whether incentives received from a local government are **government grants.** For more information please see the Government grant chapter of this webinar.

Lessee's accounting according to amendment to IFRS 16

In order to support consistent and robust application of IFRS 16, the IASB published the COVID-19-Related Rent Concessions amendment to IFRS 16 in May 2020. The amendment provides **lessees** with an **optional exemption** from assessing whether a **COVID-19-related rent concession** that meets certain conditions, is a lease modification and **require lessees to account for those rent concessions as if they were not lease modifications**.

To provide the relief when needed most, the IASB enabled immediate application of the amendment in any financial statements - interim or annual - not authorised for issue at the date the amendment was issued

The exemption shall be applied retrospectively, recognising the cumulative effect of initially applying the amendment as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of the reporting period in which a lessee first applies the amendment.

This **optional exemption** is provided only for lessees. If a lessee does not apply the optional exemption of the amendment, the accounting treatment described in **FAQ 4.1****.** should be followed.

Lessee's accounting according to amendment to IFRS 16

In order to support consistent and robust application of IFRS 16, the IASB published the COVID-19-Related Rent Concessions amendment to IFRS 16 in May 2020. The amendment provides **lessees** with an **optional exemption** from assessing whether a **COVID-19-related rent concession** that meets certain conditions, is a lease modification and **require lessees to account for those rent concessions as if they were not lease modifications**.

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The exemption shall be applied retrospectively, recognising the cumulative effect of initially applying the amendment as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of the reporting period in which a lessee first applies the amendment.

This **optional exemption** is provided only for lessees. If a lessee does not apply the optional exemption of the amendment, the accounting treatment described in FAQ 4.1. should be followed.

The practical expedient of the amendment applies only to rent concessions occurring as a **direct consequence of the COVID-19** pandemic and only if **all** of the following conditions are met:

- the change in lease payments results in **revised consideration** for the lease that is substantially **the same** as, **or less** than, the consideration for the lease immediately preceding the change;
- any **reduction** in lease payments affects only payments originally **due on or before 30 June 2021**; and
- there is **no substantive change to other terms** and conditions of the lease, considering both qualitative and quantitative factors.

Lessee's accounting according to amendment to IFRS 16

In order to support consistent and robust application of IFRS 16, the IASB published the COVID-19-Related Rent Concessions amendment to IFRS 16 in May 2020. The amendment provides **lessees** with an **optional exemption** from assessing whether a **COVID-19-related rent concession** that meets certain conditions, is a lease modification and **require lessees to account for those rent concessions as if they were not lease modifications**.

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The exemption shall be applied retrospectively, recognising the cumulative effect of initially applying the amendment as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of the reporting period in which a lessee first applies the amendment.

This **optional exemption** is provided only for lessees. If a lessee does not apply the optional exemption of the amendment, the accounting treatment described in FAQ 4.1. should be followed.

A lessee that chooses to apply the practical expedient shall apply it consistently to all lease contracts with similar characteristics and in similar circumstances.

Lessee’s accounting according to amendment to IFRS 16

Let’s discuss how a lessee applying the practical expedient would account for the two basic types of change in lease payments.

Reduction in lease payments

Deferral of lease payments

Lessee's accounting according to amendment to IFRS 16

Let's discuss how a lessee applying the practical expedient would account for the two basic types of change in lease payments.

Reduction in lease payments

Deferral of lease payments

Reduction in lease payments

Where the concession takes the form of a reduction in the payments required by the lease contract, with no change in the scope of the lease and without substantive change to other terms and conditions of the lease, a lessee would account for a reduction in lease payments as **variable lease payments** that are not dependent on an index or a rate and would also make a corresponding **adjustment to the lease liability** to derecognise the part of the lease liability that has been forgiven.

Lessee: The effect is recognised in profit or loss in the period in which the event or condition that triggers the reduced payments occurs with a corresponding adjustment to the lease liability.

Lessee’s accounting according to amendment to IFRS 16

Let’s discuss how a lessee applying the practical expedient would account for the two basic types of change in lease payments.

Reduction in lease payments

Deferral of lease payments

Reduction in lease payments

Where the concession takes the form of a reduction in the payments required by the lease contract, with no change in the scope of the lease and without substantive change to other terms and conditions of the lease, a lessee would account for a reduction in lease payments as **variable lease payments** that are not

Variable lease payments
Lease liability is the present value of the future lease payments during the lease term.
A lease contract may contain variable lease payments, which are contingent payments depending on the underlying variable:

- payments based on an index or a rate (for example payments linked to a consumer price index);
- payments not based on an index or a rate (for example payments based on the revenue resulting from a retail store); and
- in-substance fixed payments.

According to IFRS 16 variable lease payments based on an index or a rate are part of the lease liability, while **variable lease payments that are not based on an index or a rate** are not part of the lease liability, but they **are recognised in the income statement** when the event or condition that triggers those payments occurs.

Lessee’s accounting according to amendment to IFRS 16

Let’s discuss how a lessee applying the practical expedient would account for the two basic types of change in lease payments.

Reduction in lease payments

Deferral of lease payments

Deferral of lease payments

Where the concession takes the form of a change in lease payments that reduces payments in one period but proportionally increases payments in another period, it does not extinguish the lessee’s lease liability or change the consideration for the lease. It changes only the timing of individual payments. In this case, a lessee would **continue to** both **recognise interest** on the lease liability and **reduce that liability** to reflect lease payments made to the lessor.

As a result of the change in the timing of lease payments, lessees shall calculate the present value of future lease payments using the original discount rate. The difference between the carrying value of the lease liability and the new present value shall be treated as a cumulative catch up adjustment.

Lessee: After accounting for the cumulative catch up adjustment, the lessee would continue to increase the carrying amount of the lease liability to reflect interest and reduce the carrying amount of the lease liability to reflect lease payments made.

As a result of COVID-19 pandemic lessee A receives a rent concession, which results in reduced lease payments before 30 June 2022 and increased lease payments that extend beyond 30 June 2022. Beside this change there are no other changes to the terms and conditions of the lease.

Can lessee apply the practical expedient provided by the amendment to IFRS 16?

Yes

No

As a result of COVID-19 pandemic lessee A receives a rent concession, which results in reduced lease payments before 30 June 2022 and increased lease payments that extend beyond 30 June 2022. Beside this change there are no other changes to the terms and conditions of the lease.

Can lessee apply the practical expedient provided by the amendment to IFRS 16?

Yes

No

The practical expedient provided by the amendment to IFRS 16 can be applied to rent concessions which are a direct consequence of the COVID-19 pandemic and if all of the following criteria are met:

- the change in lease payments results in revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change;
- **any reduction in lease payments affects only payments originally due on or before 30 June 2021**; and
- there is no substantive change to other terms and conditions of the lease.

According to the above mentioned, rent concession, which results in reduced lease payments before 30 June 2021 and increased lease payments that extend beyond 30 June 2021 can meet the conditions of the amendment, but if reductions in lease payments extend beyond 30 June 2021 (like in this example), the rent concession in its entirety would not be within the scope of the practical expedient!

Leases – Test your understanding

Assume a lessee has a lease liability for a store that requires monthly lease payments of CU 100. As a result of COVID-19 the government has forced all non-essential stores to close until the government decides it is safe to reopen. On 31 March 2020, the lessor forgives the lease payments for April, May and June on the condition that the store remains closed under government restrictions and there is genuine uncertainty about the timing of the reopening.

What would be the accounting treatment of the 3 months payment reduction, if the lessee applies the practical expedient provided by the amendment to IFRS 16?

The effect would be recognised in profit or loss during the 3 months period with a corresponding adjustment to the lease liability.

The effect would be recognised as lease modification, by adjusting the lease liability with a corresponding adjustment to the right-of-use asset.

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What would be the accounting treatment of the 3 months payment reduction, if the lessee applies the practical expedient provided by the amendment to IFRS 16?

The effect would be recognised in profit or loss during the 3 months period with a corresponding adjustment to the lease liability.

The effect would be recognised as lease modification, by adjusting the lease liability with a corresponding adjustment to the right-of-use asset.

The lessee would recognise a credit of CU 100 in profit or loss in each month of April, May and June and a corresponding debit of CU 100 to the lease liability in each month as well because of the condition that the store remains closed under government restrictions.

The effect is recognised in profit or loss during the 3 months period.

Measurement and recognition issues

This seminar will cover measurement and recognition issues of the following items:

Please note, that this is not an exhaustive list of all the possible accounting implications. Each entity needs to analyze its own conditions and circumstances and, based on that assessment, should decide on the correct accounting treatment.

- Impairment of non-financial assets
- Fair value measurements
- Provisions
- Government grants
- Financial instruments
- Deferred tax assets/liabilities
- Property, plant and equipment
- Leases
- Revenue
- Other?

What might the possible effects of COVID-19 be on recognition of deferred tax assets?

COVID-19 could affect future taxable profits either directly or indirectly through its impact on the entity’s customers, suppliers and service providers.
Asset impairment may also reduce the amount of deferred tax liabilities and/or create additional deductible temporary differences.
COVID-19 could affect management’s plans to distribute profits from subsidiaries, so it might be necessary to reconsider the recognition of any deferred tax liability in connection with undistributed profits.

According to IAS 12 – Income taxes, a **deferred tax asset should be recognised** for all deductible temporary differences and tax losses/tax credits carried forward **to the extent that it is probable (more likely than not) that taxable profit will be available against which the deductible temporary difference and tax losses carried forward can be utilized.**
Entities with deferred tax assets should reassess forecast profits and the **recoverability of deferred tax assets** taking into account the additional uncertainty arising from changed circumstances.

Deferred tax assets/liabilities

Tax losses

To determine whether a **deferred tax asset** in respect of unused tax losses should be **recognised**, an entity should consider:

- whether it has **sufficient taxable temporary differences** relating to the same taxation authority and the same taxable entity;
- whether it is **probable** that it **will have taxable profits** before the unused tax losses expire;
- whether the unused tax losses result **from identifiable causes** which are **unlikely to recur**; and
- whether there are **tax planning opportunities available** that will create taxable profit in the period in which the unused tax losses can be utilised.

IAS 12 requires convincing evidence of sufficient future taxable profits to support the recognition of a deferred tax asset for losses carried forward where there are insufficient deferred tax liabilities.

This is because the existence of tax losses is strong evidence that future taxable profit might not be available.

The amount of the deferred tax asset and the nature of the evidence supporting its recognition should be disclosed.

Tax losses might result from identifiable causes. If those losses are likely to recur, it is unlikely that a deferred tax asset can be recognised.

As a result of COVID-19, it might be challenging for some entities that do not have appropriate taxable temporary differences to obtain convincing evidence to support recognition of a deferred tax asset.

What is 'convincing evidence'?

There is no specific definition of convincing evidence. When an entity has a history of recent losses, management should exercise **judgement** to determine whether there is convincing evidence that sufficient taxable profit will be available against which tax losses can be used.

Does a forecast or budget in itself provide such convincing evidence?
Unfortunately it doesn't. The forecast and the underlying assumptions used **should be supported by reliable evidence**. In making this judgement, management should consider all relevant facts and circumstances and are expected to give more weight to evidence that is objectively verifiable than to evidence that is subjective.
Management might consider the following factors when assessing whether its forecasts of taxable profit support the recognition of a deferred tax asset:

- the impact of one off or non-recurring items on historical results
- the entity's earnings history
- the accuracy of the entity's previous forecasts
- the length of forecasting period needed to support the deferred tax assets
- the background to and extent of unused tax losses and tax credits
- the existence of sales contracts or firm commitments
- whether there is a restructuring plan that will reduce costs and whether it has been implemented
- completed acquisition and disposals
- whether there are losses expected in the near term.

As a result of COVID-19 management should consider the following areas when assessing recoverability of a deferred tax asset:

- what industry does the entity operate in and how the industry has been impacted,
- how has the entity's business been affected by the crisis,
- has the business begun to recover,
- what are the projections for the future,
- how are the entity's customers and suppliers affected by the virus.

This list is not exhaustive and should be tailored to the individual circumstances of the reporting entity.

Deferred tax assets/liabilities

What do you think…?

Should the projections about future taxable profits used to consider deferred tax assets be consistent with those used for the impairment?

- Yes
- No

Deferred tax assets/liabilities

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Should the projections about future taxable profits used to consider deferred tax assets be consistent with those used for the impairment?

- **Yes**
- No

The underlying assumptions used to assess impairment under IAS 36 and to test recovery of deductible temporary differences and tax losses in IAS 12 , should be the same. For example, if the impairment model assumes no recovery in sales until the second half of 2021, the model used to test the recovery of deferred tax asset should use the same assumption. There are differences in the application of the models (for example CGUs, tax laws, restructuring, discounting etc) but the underlying assumptions are the same.

Deferred tax assets/liabilities

What do you think…?

Should there be deferred tax asset if there are sufficient taxable temporary differences although there will be future losses?

- Yes
- No

Deferred tax assets/liabilities

What do you think…?

Should there be deferred tax asset if there are sufficient taxable temporary differences although there will be future losses?

- **Yes**
- No

That’s right!
If the **entity** has sufficient taxable temporary differences that can be offset in the future with tax losses or with the reversal of deductible temporary differences, the entity recognises a deferred tax asset even if it expects to generate tax losses in the future. The IFRIC confirmed in a May 2014 agenda decision that even if an entity expects to make losses, deferred tax assets should be recognised to the extent of suitable deferred tax liabilities.

Taxable entity

Entities can sometimes form ‘tax groups’, within which tax losses or other deductible temporary differences could be transferred between entities.
The availability of sufficient taxable temporary differences in the same taxable entity shall be considered first before looking for potential future taxable profits. The taxable entity in the context of consolidated financial statements means the wider group of entities in the same tax group.

Deferred tax assets/liabilities - Test your understanding!

Can a deferred tax asset which was derecognised due to the negative economic impact of COVID-19 be recognised again in a future period?

Yes

No

Deferred tax assets/liabilities - Test your understanding!

Can a deferred tax asset which was derecognised due to the negative economic impact of COVID-19 be recognised again in a future period?

Yes

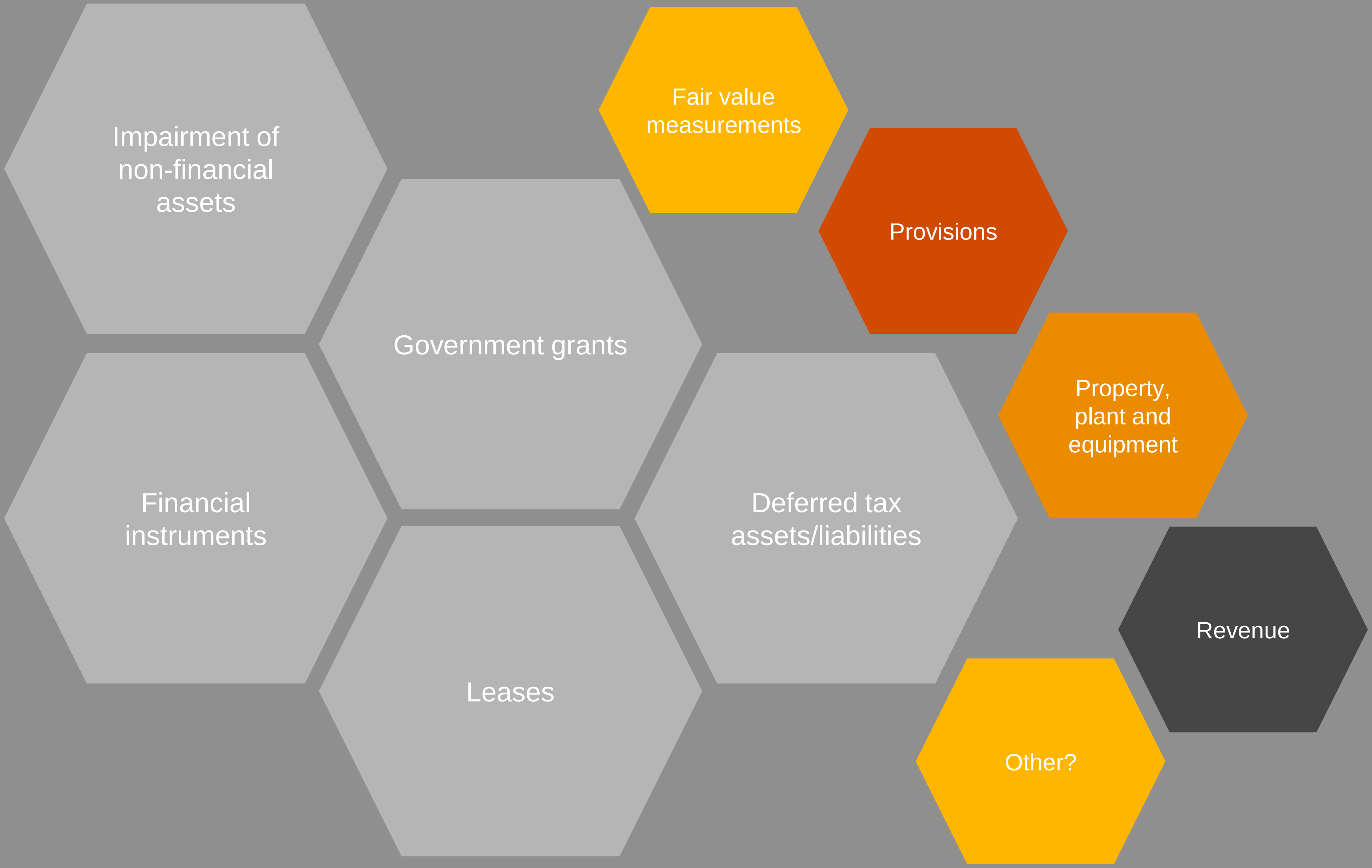
No

If an entity’s estimates of future taxable profits improve after the economy recovers after the pandemic and becomes probable that sufficient future taxable profits will be available, the previously derecognised deferred tax asset shall be recognised again.

Measurement and recognition issues

This seminar will cover measurement and recognition issues of the following items:

Please note, that this is not an exhaustive list of all the possible accounting implications. Each entity needs to analyze its own conditions and circumstances and, based on that assessment, should decide on the correct accounting treatment.



Fair value measurement

Considering fair value measurement, it is obvious that COVID-19 had significant impact on market prices, share prices, interest rates, counterparty credit risk, credit spread, etc., which resulted in volatile fair values.

The fair value of an asset or liability at the reporting date should be determined in accordance with the applicable IFRS standards.

Fair value measurement

According to IFRS 13 – *Fair value measurement,* fair value is the **price** that would be received to sell an asset, or paid to transfer a liability, **in an orderly transaction between market participants at the measurement date**.

Since the fair value of an asset should reflect a hypothetical **exit transaction** at the reporting date, changes in market prices after the reporting date are not reflected in asset valuation. A fair value measurement is based **on information available at the date of measurement**. Information that becomes known after the measurement date is only taken into account where reasonable and customary due diligence would have identified the additional information at the measurement date.

Also, a fair value measurement should be **based on the assumptions of market participants**. It is not an entity-specific measurement.

Volatility of prices on various markets can affect the fair value measurement in two ways:

- **directly**, if fair value is determined based on observable market prices
- or **indirectly**, if valuation techniques are used.

Counterparty credit risk and the credit spread that is used to determine fair value might also increase. However, the impact of actions taken by governments to stimulate the economy might reduce risk free interest rates.

IFRS 13 applies to all fair value measurements or disclosures that are either required or permitted by other standards, except: share-based payments under IFRS 2; leasing transactions accounted for in accordance with IFRS 16; and measurements that are similar to (but are not) fair value, including the net realisable value measure in IAS 2, and the value-in-use measure in IAS 36.

Fair value measurement – Test your understanding

Entity A has an investment in an unlisted equity security (investment P) which is classified as FVTPL. Entity A has a 31 December year end.
Management performs the valuation of investment P in early January, based on information available at the time about the financial performance of the investment P as of 31 December.

At the beginning of February management receives the January results for investment P, which are worse than would have been anticipated at the end of December. This information if incorporated in the model would inevitably result in a different value from the fair value figures calculated in early January.

Should entity A revise its fair value estimates, based on the new information obtained from January results?

Yes

No

That's right!

The entity should revise its fair value estimates only if the information could have been known by a market participant that undertook usual and customary due diligence efforts, sufficient to be knowledgeable enough about the asset or liability to be willing to transact at the measurement date.

Since January results are worse than **would have been anticipated** at the end of December, the fair value estimate of investment P should not be updated.

Provisions

COVID-19 has negatively affected many entities and as a result, surviving businesses will incur significant recovery costs.

According to IAS 37 - *Provisions, contingent liabilities and contingent assets*, is it possible to recognise provision for future business recovery cost?

- Yes
- **No**

IAS 37 does not permit provisions for future operating costs or future business recovery costs.

Why?

Because of the recognition requirements of a provision, which are the following:

- an entity has a present obligation as a result of a past event;
- it is probable that an outflow of resources is required to settle the obligation;
- and a reliable estimate can be made.

Provisions	should be recognized if it is more likely than not that a present obligation exists at the balance sheet date.
Contingent liability	should be disclosed if it is more likely that no present obligation exists at the balance sheet date.
Contingent asset	should be disclosed only if an inflow of economic benefits is probable.

Provisions

A liability exists only when something **has happened in the past** (a ‘past event’, the so called **“obligating event”**) to trigger a present obligation. Future operating cost or future business recovery cost does not meet the definition of a present obligation, because although it’s true that, due to circumstances, it might happen that the entity will incur additional recovery costs in the future, but these facts do not create a legal or constructive obligation if they can be avoided. And these costs can be avoided by, for example, discontinuing part of the operation.
On the other side, expected future operating losses are an indication that an impairment review is required in accordance with IAS 36 (as we have covered earlier in this e-learn).

Let’s get the overview of the main topics covered by IAS 37, on which we have to focus as a result of COVID-19.

Think about the following example:

Entity A's management has prepared a plan to reduce the number of retail outlets as a result of COVID-19. The board has approved the plan, which involves closing 10 of entity A's 50 retail outlets. Management will conduct further analysis before deciding which outlets to close. Management has announced its intentions publicly and believes that this has given rise to a valid expectation for those affected.

Should a provision for restructuring costs be recognised?

- Yes
- No

Restructuring

A restructuring provision is recognised only when an **obligating event occurs**. The obligation in this case is often constructive. A constructive restructuring obligation arises only when both of the following criteria are met:

- A **detailed formal plan** for restructuring exists (when, what, where, expenditures, etc.)
- **A valid expectation** in those affected exists that the entity will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

In the previous example, a provision for restructuring **should not be recognised**. A constructive obligation arises only when an entity has both a detailed formal plan for restructuring and makes an announcement of the plan to those affected by it. The plan does not provide sufficient detail (for example, the principal locations affected) that would permit recognition of a restructuring provision.

Provisions should be recognized if it is more likely than not that a present obligation exists at the balance sheet date.

Contingent liability

If it is **only possible that there is a present obligation** (but the probability is more than remote), or we could say if it is **more likely that no present obligation** exists at the reporting date, and the information is significant, it should be disclosed in the notes to financial statements.

Contingent asset

One outcome of COVID-19 was the temporary closing down of some businesses. For such circumstances an entity might have **business continuity insurance** and be able to recover some or all of the costs of closing down.

The question arises: When can this receivable be recognised?
A receivable can be recognised when the recovery is **virtually certain** (much stronger than the “more likely than not” criteria). In the case of insurance related receivables, typically it can be recognised when **the insurer has accepted that there is a valid claim** and management is satisfied that the insurer can meet its obligations. The benefit of insurance is therefore often recognised later than the costs for which it compensates.

If the inflow of economic benefits is only probable, if it is significant, it should be disclosed in the notes to financial statements.

Contingent liability	should be disclosed if it is more likely that no present obligation exists at the balance sheet date.
Contingent asset	should be disclosed only if an inflow of economic benefits is probable.

Other items

Other financial statement line items that might be affected as a result of COVID-19 are:

- Property, plant and equipment
- Revenue,
- Employee benefit and share-based payment.

Other items – Property, plant and equipment - Test your understanding

Entity A owns and operates a local airline. The aircraft engine can fly 5,000 flight hours before it must be replaced, which would cover seven years of flight paths. However, the entity has a policy to replace its engines every five years, irrespective of the number of flight hours. Entity A therefore determines that the engine's economic benefits are limited by time, and straight-line depreciation is the most appropriate depreciation method.

During Q1 of 2020, entity A's fleet of planes is grounded due to travel restrictions imposed to reduce the spread of COVID-19. It is unknown when these restrictions will be lifted. Entity A still considers the useful life of the engine to be five years, following its policy to replace its engines at this time.

Can entity A stop depreciating the aircraft engine?

Yes

No

According to IAS 16 depreciation does not cease when an asset is idle. The depreciation charge can be zero while there is no production only if an asset is depreciated using a unit of production method.

Given that entity A has determined that the economic benefits of the engine are limited by time, it would be inappropriate to change to a units of production method of depreciation. An entity would need to demonstrate that an asset is no longer consumed over time to change to a production method, **which would be rare**.

Entity A should continue to depreciate during the time when the aircraft are grounded.

Other items

Other financial statement line items that might be affected as a result of COVID-19 are:

- **Property, plant and equipment**
- **Revenue,**
- **Employee benefit and share-based payment.**

Property, plant and equipment

As we have already discussed in relation to non-financial assets' impairment issues, the virus and government imposed restrictions on assets might mean that property, plant and equipment is under-utilised or not utilised for a period, or that capital projects are suspended.

Beside the high probability that an **impairment test** will have to be performed, the question arises whether depreciation can be suspended if the asset is temporarily out of use. IAS 16 - *Property, plant and equipment* requires that **depreciation continues to be charged** in the income statement even if the asset is temporarily idle, unless an asset is depreciated using a unit of production method.

Another related question might be capitalisation of borrowing costs if capital projects are temporarily suspended. IAS 23 - *Borrowing costs* requires that the **capitalisation of interest is suspended** when development of an asset is suspended.

Revenue – Test your understanding

Entity A sells coffee machines for years. List price is CU 100.
The observable data indicate that historically entity A grants price concessions ranging from 10–30% of the sales price.
According to IFRS 15 entity A decides to use the expected value method to estimate the variable consideration to which the entity will be entitled, and estimates that a discount of 20% will be provided so the variable consideration is:
80% x CU 100 x 1,000 products = CU 80,000.
Current market information suggests that a 30–50% reduction in price may be necessary to be able to sell the products. Entity A observes that as a result of COVID-19 the amount of consideration is highly dependent on factors outside the entity's influence and it is likely that entity A may be required to provide a broad range of price concessions.

Can entity A include its estimate of CU 80,000 in the transaction price?

Yes, as CU 80,000 is the estimated amount using the expected value method.

No, because entity A cannot conclude that it is highly probable that a significant reversal of amounts recognised will not occur in the future.

According to IFRS 15 the transaction price in a contract reflects the amount of consideration that an entity expects to be entitled to in exchange for goods or services transferred. A price concession is an example of variable consideration. Variable consideration is recognised only to the extent that it is **highly probable that amounts recognised will not be reversed** in the future when the uncertainty associated with the variable consideration is subsequently resolved.

Although entity A estimates that the variable consideration to which the entity will be entitled is CU 80,000 using the expected value method, current market information suggests that a price concession of 30-50% will be necessary.

Consequently, in case of entity A it is highly probable that a significant reversal in the cumulative amount of revenue recognised will not occur if entity A includes CU 50,000 in the transaction price (CU 100 and a 50% price concession) and therefore, recognises revenue at that amount. Entity A should reassess the estimates of the transaction price at each reporting date until the uncertainty is resolved.

Other items

Other financial statement line items that might be affected as a result of COVID-19 are:

- **Property, plant and equipment**
- **Revenue,**
- **Employee benefit and share-based payment.**

Revenue

Sales activity, and thus revenue, might decline as a result of reduced economic activity. This is accounted for when it happens.

However, there could also be an **effect on the assumptions** made by management in measuring the revenue from goods or services **already delivered** and, in particular, on the measurement of **variable consideration**. For example, reduced demand could lead to an increase in expected returns, additional price concessions, reduced volume discounts, penalties for late delivery or a reduction in the prices that can be obtained by a customer. All of these could affect the measurement of variable consideration.

IFRS 15 – *Revenue from contracts with customers* requires that variable consideration is recognised only when it is **highly probable** that amounts recognised will not be reversed when the uncertainty is resolved. Management should reconsider both its estimate of variable consideration (as discussed before) and whether the **recognition threshold** is met.

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

Other items

Other financial statement line items that might be affected as a result of COVID-19 are:

- Property, plant and equipment
- Revenue,
- Employee benefit and share-based payment.

Employee benefits and share-based payments

Management should consider whether any of the **assumptions** used to measure employee benefits and share based payments should be **revised**.

For example, the yield on high-quality bonds or the risk-free interest rate in a particular currency might have changed as a result of COVID-19 or the probability of an employee meeting the **vesting conditions** for bonuses or share-based payments might have changed.
Management should consider the impact of any changes made to the terms of, for example, a share-based payment plan, to address the changes in the economic environment and the likelihood that performance conditions will be met. **To the extent that such changes are beneficial to the employee, they would be accounted for as a modification and an additional expense recognised**.
Management should be aware that **cancelling a share-based payment** award, even if the vesting conditions are unlikely to be satisfied, results in the immediate recognition of the remaining expense!

Management should also consider whether it has a legal or constructive obligation to its employees in connection with the virus, for example payments to employees, for which a liability should be recognised.
Management might be considering reducing its work-force as a result of COVID-19. IAS 19 – *Employee benefits* requires that **a liability for employee termination is recognised only when the entity can no longer withdraw the offer** of those benefits or the costs of a related restructuring are recognised in accordance with IAS 37.

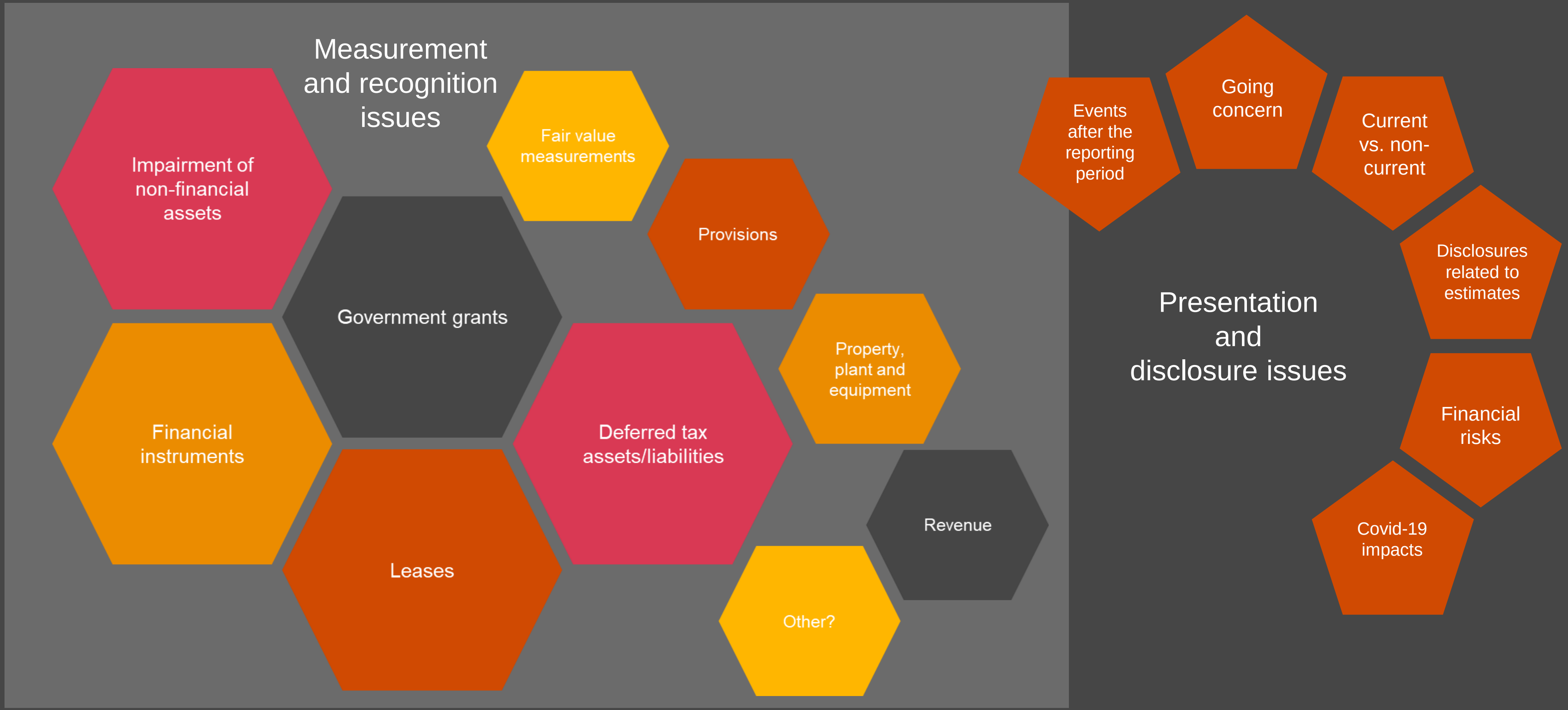
Agenda

- Introduction
- Presentation and disclosure issues
- Measurement and recognition issues
- Closing remarks

Congratulations

You have successfully reached the end of this seminar on **COVID-19 related financial reporting issues**. We have reviewed – using practical examples – several areas of financial reporting, which could mostly be affected by COVID-19.

As a short summary, the following areas were covered:



If you have any specific questions related to the topics covered in this seminar, please consult with PwC's experts!

COVID-19 Link Utili e informazioni utili:

1. PwC IFRS Manual of Accounting (per chi è abbonato o ha una copia del manuale) e altre pubblicazioni PwC in merito agli impatti del Coronavirus

2. Le serie di podcast PwC su temi accounting vari https://www.pwc.com/gx/en/services/audit-assurance/ifrs-reporting/podcasts.html

3. PwC Academy, un programma di training specifico in rapida evoluzione

In depth

A look at current financial reporting issues

1 April 2020

No. 2020-02

Accounting implications of the effects of coronavirus

At a glance

This In depth considers the impact of the new coronavirus ('COVID-19' or 'the virus') on the financial statements for periods ending after 31 December 2019 of entities whose business is affected by the virus. There are broad IFRS implications, including:

- non-financial assets;
- financial instruments;
- leases;
- revenue recognition and government grants;
- non-financial obligations;
- going concern and events after the reporting period;
- presentation and disclosure; and
- interim financial statements.

Refer here for frequently asked questions related to the accounting implications of the effects of COVID-19.

Background

The COVID-19 outbreak has developed rapidly in 2020, with a significant number of infections. Measures taken to contain the virus have affected economic activity, which in turn have implications for financial reporting.

Measures to prevent transmission of the virus include limiting the movement of people, restricting flights and other travel, temporarily closing businesses and schools, and cancelling events. This will have an immediate impact on businesses such as tourism, transport, retail and entertainment. It will also begin to affect supply chains and the production of goods throughout the world, and lower economic activity is likely to result in reduced demand for many goods and services. Financial services entities (such as banks that lend to affected entities, insurers that provide protection to affected individuals and businesses, and funds or other investors that invest in affected entities) are also likely to be affected.

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Per saperne di più su erogazione di corsi e-learning e approfonditi su tematiche IFRS, OIC, US GAAP o specialistiche