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Accountants & Auditors Association

COVID-19 Financial and Accounting Implications

September 2020

Disclaimer

Please note this document is prepared as guidance and addresses specific to areas that need to be considered as part of the COVID-19 impact. The accounting considerations would depend on specific facts and circumstances and the full requirements of IFRS should be considered and not merely the matters discussed in the document.

Foreword

I'm pleased to bring forward this tailored guide to the business community in the United Arab Emirates (UAE) and its relevant stakeholders to aid in such times of uncertainty and navigating through uncharted territories. The Corona Virus Disease (COVID-19) pandemic has continued to develop rapidly this year. Measures implemented to restrain the outbreak and preserve human lives had undisputed setbacks for economic activity, which in turn create inevitable implications for financial reporting.

The "COVID-19 Financial and Accounting implications" guide was developed by the UAE Accountants and Auditors Association in collaboration with regulators and practitioners including the big accounting and auditing firms in the UAE.

This guide focuses on the financial and accounting implications for the key business areas impacted by COVID-19, and its treatments in accordance with International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS) as these are the official standards in the UAE. Investors, boards, managements, lenders and other stakeholders need high-quality financial information now more than ever.

Furthermore, this guide illustrates additional key accounting considerations for a number of vital business economic sectors that has significant contribution to the UAE's GDP including Energy Industry (Oil & Gas, and Utilities), Banks and Financial Services Industry, Insurance Industry, Retail Industry, Construction Industry, Real Estate Industry and Manufacturing Industry.

I would like to take this opportunity to thank UAE's Leadership for their wise ongoing efforts to combat this pandemic and to thank our Nation's first line of defense, the healthcare practitioners, for putting society's safety before their own and for their service and sacrifice.

I would also like to thank all of those who have contributed to this guidance including the accounting and auditing firms in the UAE, praying to the Great and Almighty Allah to grant us success in serving our generous country.

Riyad Al Mubarak, CPA
for, The Accountants & Auditors Association

Introduction

The coronavirus disease 2019 (COVID-19) pandemic has spread rapidly across the world and caused an extensive disruption to the entire global economy due to its increase in both magnitude and duration. In the United Arab Emirates, similarly to other countries around the world, measures and precautions were taken, such as travel and transport restrictions, lockdown and quarantine, and limitations of operating activities of businesses have been enforced. Due to this prolongation of the pandemic threat, entities are experiencing conditions that are associated with a global economic slowdown, which lead to the increase in the intervention of the Governments, increase in the unemployment rate due to layoffs, decrease in demand causing a reduction in production and increase in the level of inventory, restructuring activities and many other consequences.

To this extent, a quick response on the economic and financial impact of the COVID-19 outbreak was required, in order to address the financial effects of COVID-19 when preparing the financial statements.

Under the sponsorship of the UAE Ministry of Economy and the Securities & Commodities Authority (SCA), The UAE Accountant & Auditors Association established a task-team of experts and practitioners to study the financial and accounting implications of COVID-19. The task team, which includes experienced practitioners from the big accounting and auditing firms in the UAE, worked together to bring forward this detailed guideline on the accounting and financial reporting requirements that will need to be considered for the purpose of helping the UAE business community to overcome this unprecedented situation.

This guideline discusses key business areas in relation to accounting and disclosure issues to be considered by the business arising from the COVID-19 outbreak in preparing the financial statements. It also illustrates additional key accounting considerations for a number of vital business economic sectors that has significant contribution to the UAE's GDP including Energy Industry (Oil & Gas, and Utilities), Banks and Financial Services Industry, Insurance Industry, Retail Industry, Construction Industry, Real Estate Industry and Manufacturing Industry.

This document is prepared as guidance and addresses specific areas that need to be considered as part of the COVID-19 impact. The accounting considerations would depend on specific facts and circumstances and the full requirements of IFRS should be considered and not merely the matters discussed in the document.

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Financial Sustainability and Going Concern (IAS 1)

1. Introduction

Globally, businesses and stakeholders are evaluating their operational resilience and the likelihood of their survival during the pandemic and beyond. In such upheaval, the question arises about how to deal, timely, with the going concern assumption of an entity and the possible effects of this pandemic on its financial reporting.

To that extent, it is crucial to plan ahead, consult with various stakeholders, adopt early communication strategies and take into account any material uncertainties that cast doubt on going concern. What has been outlined below is some of the considerations to be taken into account by the Business (Board of Directors, Audit Committees, Management and CFOs collectively referred to as "Business") and Auditors to ensure sufficient, relevant and reliable financial information is provided to the market and its participants.

A. Measurement

Under IFRS, management is required to assess a company's ability to continue as a going concern. A company is no longer a going concern if management either intends to liquidate the entity or cease trading, or has no realistic alternative but to do so. [IAS 1.25]

In assessing whether the going concern assumption is appropriate, management assesses all available information about the future (which is at least, but not limited to, 12 months from the reporting date), considering the possible outcomes of events and changes in conditions, and the realistically possible responses to such events and conditions that are available. [IAS 1.26]

What to think about:

- In many cases, 2020 budgets and forecasts prepared in 2019 may now be of limited relevance given the rapidly changing economic and business circumstances. These may require significant revision - e.g. for forecast sales, gross margins and changes in working capital - to be able to support management's assessment in the current environment.
- It is important that management's assessment considers different scenarios, including a reasonably plausible downside scenario. After updating the forecasts, management will need to assess whether it expects to remain in compliance with financial covenants.
- It will be critical for management to assess what impacts the current events and conditions have on a company's operations and forecast cash flows, with the key issue being whether a company will have sufficient liquidity to continue to meet its obligations as they fall due.
- For example, a company may need to consider whether:
  - Changes in the entity's business model and related impact;
  - Calculating actual current cost of COVID-19 (safety measures, distancing, changes in supply chain, etc);

- Decline/loss of revenues;
- Investments required to cope with COVID-19 and future impacts on business model;
- Cash flow and working capital (including financing costs);
- Inability to meet current obligations or contractual matters;
- Failure to comply with debt covenants or renegotiate term loans nearing maturity;
- Does the Business qualify for Government Support?;
- Supply chain disruptions;
- Has the Business considered stress testing the business model for additional outbreaks; and
- Obtaining relevant approvals and sign offs for the going concern assessment prior to financial period closing. For eg.:
  - Management should reassess the availability of finance because it may not be easily replaced and the costs may be higher in the current circumstances.
  - Ratings may find it more difficult to access bond markets, and may find banks and other lenders less willing to renew or increase borrowing facilities.
  - Lenders may demand new terms, such as significantly higher yields or improved collateral, particularly for companies in highly exposed sectors.
  - Lenders themselves may be experiencing liquidity issues and may need central bank assistance to be able to continue to provide, or increase, financing.
  - Borrowers with foreign currency-denominated debt may find that debt servicing costs increase significantly due to the depreciation of their local currency.
  - Covenants in loan agreements may provide lenders with an opportunity to withdraw financing.
  - If management concludes that the consequences of the outbreak will result in a deterioration in operating results and financial position after the reporting date that is so severe that the going concern assumption is no longer appropriate, then the financial statements would need to be adjusted - i.e. a change in the going concern assumption is considered an adjusting event. [IAS 10.14–15]

B. Disclosure

Disclosures are required where there are significant doubts about the entity's ability to continue as a going concern. The uncertainties should be disclosed, even if the financial statements continue to be prepared on a going concern basis. [IAS 1 para 25].

What to think about:

- To the extent that events and conditions are identified that may cast significant doubt on a company's ability to continue as a going concern, disclosure of uncertainties is required if these events constitute material uncertainties or management's conclusion that there are no material uncertainties involved significant judgement.
- Supply chain, logistics and other disruptions or significant changes in demand can have implications for a company's working capital. Many companies would need to adjust the way they manage liquidity to respond to the current market turmoil, including the use of alternative sources of funding. Additional disclosures will be needed, explaining those changes and how the company manages its liquidity in these difficult economic conditions.
- IFRS 7 Financial Instruments: Disclosures requires disclosure of quantitative data about liquidity risk arising from financial instruments. A company also needs to explain how it is managing this risk, including any changes from the previous period and any concentrations of liquidity risk. Disclosures addressing these requirements may need to be expanded, with added focus on the company's response to the impact of COVID-19. [IFRS 7.33]

- Examples of specific disclosures required include:
    - An explanation of how a company manages liquidity risk; and
    - Disclosures of defaults and breaches relating to the borrowings recognised during and at the end of the reporting period. [IFRS 7.18–19, 39(c)].
    - Given the significance and widespread impact of COVID-19, expanded disclosures may be necessary.

2. For Business

The impact of COVID-19 on the accounting for the business will be dependent on each entity's specific facts and circumstance. Business should consider:

Going concern

- When assessing a company's ability to continue as a going concern, management may need to do the following:
    - Update forecasts and sensitivities, as considered appropriate, taking into account the risk factors identified and the different possible outcomes. It is important to consider downside scenarios - e.g. taking into account the impacts of a 'lockdown', when relevant.
    - Review projected covenant compliance in different scenarios.
    - Assess its plans to mitigate events or conditions that may cast significant doubt on the company's ability to continue as a going concern. In particular, management would be expected to reassess the availability of finance. The company needs to assess whether its plans are achievable and realistic.
- Businesses can consider formulating a plan to prepare and finalise the going concern assessment by communicating and liaising early on with those charge with governance and the auditors to understand the extent of information required.

Chapter I:

General Guidelines

Section 2: Impairment of Financial Assets (IFRS 9)

Impairment of Financial Assets (IFRS 9)

1. Introduction

Where an entity has any financial instruments that are in the scope of IFRS 9's expected credit loss model ("ECL") management should consider the impact of COVID-19 on the ECL. Instruments to be considered include loans, trade and other receivables, debt instruments not measured at fair value through profit or loss, contract assets, lease receivables, financial guarantees and loan commitments.

IFRS 9 Financial Instruments introduced changes to the calculation of bad debt provisions on trade receivables. Under IFRS 9, companies are required to account for what they expect the loss to be on the day they raise the invoice - and they revise their estimate of that loss until the date they get paid. The concept of expected credit losses ("ECLs") means that companies are required to look at how current and future economic conditions impact the amount of loss.

A. Measurement of expected credit losses

IFRS 9 establishes a general approach for measuring impairment and a simplified approach for certain financial assets. Under the general approach, impairment is generally measured as either:

- 12-month ECLs - defined as the 'portion of lifetime expected credit losses that represent the expected credit loss that result from default events on the financial instrument that are possible within the 12 months after the reporting date'; or
- Lifetime ECLs - defined as the 'expected credit losses that result from all possible events over the expected life of the financial instrument'.

What to think about:

Measuring and presenting expected credit losses ("ECLs") - reminder of the core principles and implications of the changing environment

While the uncertainties arising from COVID-19 are substantial and circumstances are certain to change, we do not expect this to preclude entities from estimating their ECLs. Estimating ECLs is challenging, but that does not mean it is impossible to estimate an impact based on the reasonable and supportable information that is available. ECLs are likely to be higher in the current environment due to adverse impact of COVID-19. A few things that may be helpful to keep in mind are:

- Significant judgement will need to be applied in assessing the range of potential outcomes so as to meet IFRS 9's requirement that the ECL reflects an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes, particularly for longer term receivables such as loan receivables or trade debtors and contract assets with a significant financing component. An unbiased estimate is one that is neither overly optimistic, nor overly pessimistic.

- Given the speed with which events are unfolding, measuring ECLs is likely to be particularly challenging. Entities will need to develop an estimate based on the best available data about past events, current conditions and forecasts of future economic conditions. Adjustments to expected loss rates in provision matrices and overlays to formal models (where used) will be needed. Updated facts and circumstances should continue to be monitored for any new information relevant to assessing the conditions at the reporting date.
- In terms of the methodology used to estimate ECL, no one size will fit all, and different approaches may work best depending on factors such as local conditions and available data. Certain debtors may receive government support and whilst such support is designed to compensate for cash flow shortages, it will take time for some of the measures to be put in place and even once in place, entities may prioritise paying items such as rent or employees over other suppliers. Hence the effects of the government support will need to be carefully considered when factoring this into the likelihood of delayed payment or customer default. Some of the points to consider are:
    - IFRS 9 always required entities to consider multiple scenarios. However, many corporates might not have done so because it did not make a material difference to the outcome in a benign economic environment. That approach may no longer be appropriate, particularly for entities with longer term loan receivables, and for trade debtors and contract assets where there is a significant financing component.

      For example, entities might add one or more scenarios to reflect a more severe downside(s) and/or to increase the weighting allocated to downside scenarios. Core scenarios which assume a very low probability of default may be difficult to support. Estimates are likely to be refined as additional information becomes available that is relevant to assessing conditions at the reporting date.
    - Only financial guarantees or other forms of credit insurance that are integral to the financial asset may be taken into account in measuring the ECL. A common example in some groups is where 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 - it does not reduce the likelihood of default. Management should also consider whether the party providing the guarantee or insurance is likely to be able to meet its obligations when called upon. This may be particularly relevant for intercompany guarantees of loans in standalone accounts. Also, review the estimated loss as a result of default (loss given default); for example, this might increase if COVID-19 results in a decrease in the fair value of a non-financial asset pledged as collateral.
    - Where contractual payment dates are extended or amounts are expected to be received later than when contractually due, this may give rise to an ECL unless either additional compensation is received for the lost time value of money, or the EIR is 0%. This may particularly affect longer term receivables such as lease receivables, some contract assets and loans.
    - Because of the short-term nature of trade receivables, many companies may not have needed to consider updating ECL estimates for changes in future economic conditions relative to historic experience. However, they may now need to revisit this given the severe economic impacts of the COVID-19 outbreak.

Whether the ECL is measured at a 12-month or lifetime ECL?

If the credit risk (risk of default) has increased significantly since initial recognition, the ECL is measured at the lifetime ECL rather than the 12-month ECL (except for assets subject to the simplified approach, such as short-term receivables and contract assets, which are always measured using lifetime ECL).

B. Assets measured using the simplified approach

IFRS 9 allows a simplified approach for trade receivables or contract assets that result from transaction in the scope of IFRS 15, and lease receivables that result from transactions in the scope of IAS 17/IFRS 16. Under the simplified approach, the loss allowance is always equal to lifetime ECLs.

	Simplified Approach
Applies to	Qualifying trade receivables, IFRS 15 contract assets and lease receivables
Timing of initial recognition	Same period as asset is acquired
Measurement basis of the loss allowance	Lifetime ECLs

What to think about:

Implications for trade receivables, lease receivables and contract assets measured using the simplified approach?

- Financial instruments within the scope of IFRS 9's ECL model include trade and other receivables, loan receivables and other debt investments not recognised at fair value through profit or loss (including intercompany loans), contract assets, lease receivables, financial guarantees and loan commitments.
- For many corporate groups the main balances subject to ECL will be trade receivables. As required by IFRS 9, a simplified approach of using lifetime ECL is used for measuring the ECL for such trade receivables and contract assets if they do not contain a significant financing component. Entities often calculate ECLs by using a provision matrix. The simplified approach is also permitted for lease receivables and receivables with a significant financing component, but this is an accounting policy choice.
- However, forward looking information (including macro-economic information) must still be considered in assessing the credit risk on those balances and in measuring ECL. As noted above, forward-looking information might include one or more downside scenarios related to the spread of COVID-19.
- Companies often stratify their receivables into different groupings before applying a provision matrix. For example, a company might sell to customers in different industries some of which are impacted by COVID-19 to a greater degree than others and therefore be exposed to different risks of default. Other factors that might be considered in such stratification would include geographical regions, product type, customer ratings, collateral, and the nature of the customer (for example, wholesale vs. retail).
- In considering stratification, it is important to first understand the drivers of credit risk for the underlying receivables and how these may have changed in light of the current pandemic. The level of stratification required is often a matter of significant judgment and in developing segments an entity should consider where further segmentation might be needed. Stratification may go down to the individual customer level in some cases, often described as a specific bad debt provision. For example, where a particular customer is known to be in financial difficulty, it may require an increased provision compared to historical averages over all ageing categories. It is important to consider and avoid any double counting of losses in these situations.

- In attempting to model the impact of the pandemic, companies might, as a starting point, look to the behaviour of their customers during previous recessions, thereby using historic credit loss experience as an estimate of future losses. However, given restrictions on both movement and economic activity of a similar magnitude are unlikely to have been experienced in most jurisdictions in modern times, adjustments will need to be made to that historical information to make it supportable in the current period. This could increase the expected risk of default for each time bucket in the provision matrix.
- Similarly, some customers may take longer than normal to pay, thus increasing the volume of debtors in the overdue buckets. The extent to which this delay is due to credit risk or is merely an indication of operational issues (e.g. if employees are not able to access their offices) will need to be carefully considered. Many supplier arrangements include the right to charge interest on overdue payments, but in practice it is not always implemented in order to keep good customer relationships. If entities do not intend to charge interest, then it should not be accrued. The likelihood of debtors paying, and the effect of any government initiatives will also need to be revisited in measuring ECL at the end of each reporting period.

C. Assets not measured using the simplified approach

Under the general approach, the measurement basis depends on whether there has been a significant increase in credit risk since initial recognition. ECLs are measured as lifetime ECLs if, at the reporting date, the credit risk on the financial instrument has increased significantly since its initial recognition.

	General Approach
Applies to	All other loans and receivables not covered by another approach
Timing of initial recognition	Same period as asset is acquired
Measurement basis of the loss allowance	12-month ECLs (or Lifetime ECLs if the term of the asset is shorter) unless a significant increase in credit risk occurs, then Lifetime ECLs unless the increase reverses

What to think about:

Loan receivables, including intercompany balances and other assets not measured using the simplified approach - identifying significant increases in credit risk (“SICR”)

For many corporate groups the main balances subject to ECL will be trade receivables. As required by IFRS 9, a simplified approach of using lifetime ECL is used for measuring the ECL for such trade receivables and contract assets if they do not contain a significant financing component. The simplified approach is also permitted for lease receivables and receivables with a significant financing component, but this is an accounting policy choice.

Where entities are not permitted to follow the simplified approach, or have opted not to, additional information may be needed in order to determine whether a significant increase in credit risk has occurred, and hence whether a lifetime, rather than 12-month, ECL is required. This will apply to all receivables to which the full IFRS 9 model is applied including loan receivables and most intercompany balances. Factors to consider include:

- Risk of default - SICR is based on the likelihood of a default arising, and not on the likelihood of losses. Hence, some government relief programmes may not impact SICR assessments. Those programmes that provide cash directly to debtors quickly and thus mitigate the risk of default should be considered but those that make payments directly to the reporting entity to compensate for any losses will not reduce the risk of default on the underlying receivables. If the risk of default has increased, then this may mean that a SICR has arisen, even in cases where it is expected that any losses that arise will be fully recovered.
- Payment holidays - where a corporate grants an extension of terms to a counterparty (sometimes referred to as a 'payment holiday') management should assess whether or not this indicates there has been a significant increase in credit risk, given IFRS 9 B5.5.17(m) includes a payment holiday as a potential indicator of SICR. The extension of payment holidays to all borrowers in particular classes of financial instruments should not automatically result in all those instruments being considered to have suffered an SICR". However, such 'blanket' payment holidays are not often granted by corporates and whether there has been a SICR should be assessed on a case-by-case basis in the light of the particular facts and circumstances.
- Low credit risk (“LCR”) exemption from assessing SICR - The LCR exemption is typically used for securities with an investment grade credit rating from an external credit rating agency or, in a group scenario, for intercompany receivables arising when external debt is transferred from a Treasury to an Operating company. However, there is often a time lag between the credit risk increasing and a downgrade of the external credit rating occurring. IFRS 9 only gives an external investment grade credit rating as an example of what might be considered to have low credit risk - the broader principle is that ‘low credit risk’ should be determined with reference to the perspective of a market participant. [IFRS 9 para B5.5.22]. Therefore, even if the external credit rating of a particular debtor is still investment grade, if that is only due to a time lag and a market participant would no longer consider the instrument to have low credit risk, the LCR exemption will not apply and the instrument will need to be assessed for SICR. Management should take this into account when assessing whether the LCR exemption still applies for intercompany loans that were previously deemed to have the same credit rating as other instruments issued by the borrower.
- Materiality judgements - Simplifications in previous IFRS 9 ECL measurements justified on the grounds they have no material impact should be revisited in the current environment.

D. Disclosures

IFRS 7 requires detailed disclosures on financial instruments specifically in respect the nature and extent of financial risk, how it is managed and if there have been changes in the management of financial instruments.

IFRS 7 in particular requires by class specific qualitative and quantitative disclosures.

What to think about:

Disclosures

A company will need to explain the significant impacts of COVID-19 on the risks arising from financial instruments and how it is managing those risks. It will need to use judgement to determine the specific disclosures that are relevant to its business and necessary to meet these objectives. [IFRS 7.31]

Examples of specific disclosures include the following:

- Information about a company's credit risk management practices and how they relate to the recognition and measurement of ECLs. A company may have changed its risk management practices in response to COVID-19 - e.g. by extending debt relief to borrowers or by following specific guidance issued by governments or regulators.
- The methods, assumptions and information used to measure ECLs - e.g. a company may need to explain how it has incorporated updated forward-looking information into measuring ECLs, in particular:
  - How it has dealt with the challenge of ECL models that were not designed for the current economic shocks; and
  - How it has calculated overlays and adjustments to these models.
- Quantitative and qualitative information that allows evaluation of the amounts arising from ECLs; the types of analysis disclosed previously may need to be adjusted or supplemented to clearly convey impacts arising from COVID-19.

Information on the assumptions that the company has made about the future and other major sources of estimation uncertainty at the reporting date that have a significant risk of resulting in material adjustment within the next financial year. [IFRS 7.35F, 35H–L, IAS 1.125]

IAS 1 para 82 requires presentation of IFRS 9 impairment losses on the face of the income statement as a separate line item. Impairment losses should not be netted off revenue. This separate presentation might not have been given in previous years if the ECL and year on year movements were immaterial. However, there will likely be more focus on this requirement in the wake of COVID-19 and increasing credit risk.

2. For Business

Financial statement presentation

The impact of COVID-19 on the financial instrument impairment will be dependent on each entity's specific facts and circumstance. For ECL, business should consider:

- Consider economic forecasts
  - Whether additional economic scenarios are needed;
  - Whether adjustments to model results, based on expert credit judgement, are necessary;
  - Whether the measurement appropriately captures the types of customers/issuers or regions that are particularly impacted by the economic effects of COVID-19;
  - Changes in customer behaviour such as drawing more extensively on credit lines and holding on to cash;
  - The impact of any assistance to borrowers from a government or regulator; and
  - The impact of any actions planned by the company (e.g. modification, forbearance, limit increases) on the expected cash flows.

- Consider reassessing credit risk
    - Whether to incorporate COVID-19-related changes in the risk of default into PDs for individual exposures on a timely basis;
    - Incorporating qualitative factors in identifying SICR - e.g. changes in customer behaviour or requests for payment holidays or limit increases;
    - Assessing SICR on a collective basis;
- Consider enchasing disclosures required by IFRS 7 Financial instruments: Disclosures.

Chapter I:

General Guidelines

Section 3: Hedge Accounting (IFRS 9)

Hedge Accounting
(IFRS 9)

1. Introduction

The economic turbulence resulting from the COVID-19 coronavirus pandemic may affect a company's risk exposures and how it manages them. If a company applies hedge accounting as part of its risk management strategy under IAS 39 Financial Instruments: Recognition and Measurement or IFRS 9 Financial Instruments, then it may need to consider whether:

- The hedge accounting criteria in IFRS9 or IAS 39 continue to be met;
- There is hedge ineffectiveness to recognise in profit or loss; and
- Amounts accumulated in a cash flow hedge reserve need to be reclassified to profit or loss.

A. Hedge criteria no longer met

Companies frequently enter into cash flow hedges of forecast transactions, such as purchases and sales of raw materials, and inventories. A forecast transaction can be designated as a hedged item only if it is highly probable to occur. This assessment needs to reflect the expectations at the reporting date. The COVID-19 outbreak is causing reductions in actual and forecast volumes of transactions in many regions and industries - e.g. jet fuel purchases. [IAS 39.88(c), IFRS 9.6.3.3]

If the COVID-19 outbreak reduces the probability of a hedged forecast transaction occurring or affects its timing, then the hedge accounting relationship may need to be terminated or there may be hedge ineffectiveness. Similarly, a reduction in the volume of highly probable forecast transactions may lead to partial termination under IFRS 9. [IAS 39.101(b), IFRS 9.6.5.6, B6.5.25, B6.5.27(b), BC6.317]

When a hedging relationship is discontinued because a forecast transaction is no longer highly probable, a company needs to determine whether the transaction is still expected to occur. If the transaction is:

- Still expected to occur, then gains or losses on the hedging instrument previously accumulated in the cash flow reserve would generally remain there until the future cash flows occur; or
- No longer expected to occur, then the accumulated gains or losses on the hedging instrument need to be immediately reclassified to profit or loss. [IAS 39.101(b)–(c), IFRS 9.6.5.12(a)–(b)]

In addition, any changes to the contractual terms of a financial instrument resulting from the COVID-19 outbreak may affect the instrument's eligibility as a hedged item. For example, a bank may be applying fair value hedge accounting to term deposits whose terms and conditions include significant penalties in the case of early withdrawals. If a bank waives its right to penalties to allow customers to withdraw deposits early, then the contracts could be viewed as demand deposits. This could mean that the hedging relationship is discontinued because there would be no fair value exposure to hedge. [IAS 39.AG118(b), BC87(d), IFRS 13.47]

What to think about:

- Entities often hedge risk exposures arising from forecast transactions (that is, anticipated transactions for which there is not yet a firm commitment). To qualify for hedge accounting, IAS 39 requires, among other things, the forecast transaction to be highly probable. In the context of forecast transactions, the term 'highly probable' indicates a much greater likelihood of happening than 'more likely than not'. In assessing the likelihood that a transaction will occur in light of COVID-19, there is a range of factors that might be relevant, depending on the particular facts and circumstances. These include, but are not limited to, the following:
  - The financial and operational ability of the entity to carry out the transaction (for example, retailers that have closed stores, or airlines that have curtailed operations);
  - The entity's revised business plans as a result of COVID-19;
  - The likelihood of disruptions to a particular activity (for example, a manufacturing facility that might need to be repurposed or shut down); and
  - The likelihood that transactions with substantially different characteristics might be used to achieve the same business purpose (for example, changing delivery methods for goods or services).
- Where a forecast transaction is no longer highly probable, hedge accounting must be discontinued. The appropriate treatment of accumulated other comprehensive income related to such discontinued hedges will depend on whether the transaction is still expected to occur.

B. Hedge ineffectiveness

A company considers the effect of changes in both counterparty credit risk and own credit risk when assessing hedge effectiveness and measuring hedge ineffectiveness.

What to think about:

- The increased credit risk arising from the COVID-19 outbreak could therefore affect both hedge effectiveness testing and the measurement of hedge ineffectiveness.
- In addition, if there is an increase in the credit risk of a hedging instrument, then fair value changes due to the increased credit risk are not generally offset by changes in the value of the hedged item attributable to the hedged risk. This may lead to increased ineffectiveness or even failure of the effectiveness requirements.

C. Irrecoverable losses in hedging reserve

If the amount accumulated in the cash flow hedge reserve for a particular cash flow hedge is a loss and the company expects that all or a portion of that loss will not be recovered in future periods, then it immediately reclassifies to profit or loss the amount that is not expected to be recovered. [IFRS 9.6.5.11(d)(iii).

What to think about:

- The COVID-19 outbreak may increase the risk of this occurring. For example:
  - A company is hedging future purchases of inventory and may not recover a loss on the hedging instrument through expected sales of those items; or
  - A company hedged the purchase of a fixed-rate financial asset and may not recover a loss on the hedging instrument because the financial asset has become credit-impaired. [IAS 39.97–98, IFRS 9.6.5.11(d)(iii)]

D. Disclosure

When a company applies hedge accounting, it is required to disclose how it applies its risk management strategy and the effects on its financial performance and future cash flows. [IFRS 7.21A [[IFRS 7.21A, 23E–23F, 24C(b)]

What to think about:

- It is likely that the COVID-19 outbreak will affect these disclosures and a company will need to use judgement to determine the specific disclosures that are relevant and necessary for its business. Examples of specific disclosures include:
  - Changes in how the company manages risks;
  - Impacts on hedge ineffectiveness;
  - Forecast transactions that were subject to hedge accounting but are no longer expected to occur, and the related reclassifications to profit or loss; and
  - Reclassifications of irrecoverable losses from the cash flow hedge reserve to profit or loss.

2. For Business

The impact of COVID-19 on the accounting for the business will be dependent on each entity's specific facts and circumstance. Business should consider:

Hedge accounting

- Evaluate whether forecast transactions designated as hedged items in cash flow hedges continue to be highly probable. If a transaction is not highly probable, then consider whether it is still expected to occur.
- Determine whether any changes in the contractual terms of a hedged financial instrument resulting from the COVID-19 outbreak affect the instrument's eligibility to be a hedged item.
- Evaluate whether changes in the credit risk of hedging instruments and hedged items arising from the COVID-19 outbreak affect the assessment of hedge effectiveness and the measurement of hedge ineffectiveness.
- Evaluate whether accumulated losses in the cash flow hedge reserve will be recovered in future periods.
- Consider appropriate disclosure in interim financial statements and annual financial statements in accordance with IFRS 7.

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Section 4: Fair Value Measurement (IFRS 13)

Fair Value Measurement
(IFRS 13)

1. Introduction

The COVID-19 coronavirus pandemic has significantly affected financial markets in the first quarter of 2020. Stock markets have declined sharply and volatility has increased. Treasury bond yields have reached record lows and credit-default-swap indices have been surging, reflecting concerns of increased corporate defaults. For many assets and liabilities, fair values may have changed significantly, reflecting changes in cash flow forecasts, higher uncertainty and elevated risks.

IFRS 13 Fair Value Measurement applies when another IFRS Standard requires or permits fair value measurements or disclosures about fair value measurements. Companies would need to revisit fair value decisions, assumptions and inputs at each interim and annual reporting date as new or different information becomes available.

A. Fair value measurement

IFRS 13 defines fair value as the price price that would be received to sell an asset or paid for transfer of liability in an orderly transaction between market participants at the measurement date, i.e. it is an ‘exit price’. (IFRS 13.9).

Fair value takes into account characteristics of the asset or liability that would be considered by market participants and is not based on entity’s specific use or plans (highest and best use). Such characteristics may include the condition and location of an asset or restrictions on an asset’s sale or use.

What to think about:

How has COVID-19 impacted fair value measurement?

Fair Value is measured using assumptions that market participants would use, reflecting market conditions at the measurement date. This has become more challenging due to the uncertainty of the economic impact of COVID-19.

According to IFRS 13 Fair Value Measurement, a quoted price in an active market (price that a market participant would pay) provides the most reliable evidence of fair value and if one is available then it should be used to measure fair value. Use of hindsight or adjusting for what may be viewed as depressed pricing at the measurement date in light of subsequent changes in market prices is not permitted. [IFRS 13.77, 79]. Also, a decline in volume or activity, on its own, does not necessarily indicate that the quoted price is not fair value (i.e. transactions are not orderly).

For non-financial assets, such as investment property, companies may need to revisit their decisions made regarding an asset’s highest and best use as this may have changed due to impact of COVID-19. IFRS 13 would require an assessment according to a market participant’s ability to generate economic benefits in the current environment, regardless of the asset’s current or intended use.

Companies should reconfirm an asset's or liability's principal market (i.e., the one with the greatest volume and level of activity, and determine fair value using the assumptions that market participants would use when pricing the asset or liability.

B. Active market

An active market is a market in which transactions for the asset or liability takes place with sufficient frequency and volume for pricing information to be provided on an ongoing basis. IFRS 13A.

Level 1 prices should generally not be adjusted. (IFRS 13.77).

What to think about:

What factors should be considered when determining whether market is active?

If an entity concludes that there has been a significant decrease in the volume or level of activity in the market for an asset or liability, the entity should perform further analysis of the transactions or quoted prices observed in that market. A significant decrease in activity on its own is not indicative that the transaction prices observed do not represent fair value.

Paragraph B37 of IFRS 13 provides a list of factors to consider in determining whether there has been a significant decrease in the volume or level of activity in relation to normal market activity. The factors that an entity should evaluate include (but are not limited to):

- There is a significant decline in the activity of, or there is an absence of, a market for new issues (that is, a primary market) for the asset or liability or similar assets or liabilities.
- There are few recent transactions.
- Price quotations are not developed using current information.
- Price quotations vary substantially, either over time or among market makers (for example, some brokered markets).
- Indices that previously were highly correlated with the fair values of the asset or liability are demonstrably uncorrelated with recent indications of fair value for that asset or liability.
- There is a significant increase in implied liquidity risk premiums, yields or performance indicators (such as delinquency rates or loss severities) for observed transactions or quoted prices when compared with the reporting entity's estimate of expected cash flows, taking into account all available market data about credit and other non-performance risk for the asset or liability.
- There is a wide bid-ask spread or there are significant increases in the bid-ask spread.
- Little information is publicly available (for example, a principal-to-principal market).

If there is a quoted price in an active market (that is, a Level 1 input), can a company adjust or disregard the quoted price in a period of significant market volatility when determining fair value?

The objective of 'fair value' is to determine a price at which an orderly transaction would take place between market participants under conditions that existed at the measurement date. It would not be appropriate to adjust or disregard observable transactions, except in the extraordinarily rare circumstances where those transactions are determined to not be orderly. Generally, there is an extremely high bar to conclude that a transaction price in an active market (that is, a Level 1 input) is not orderly under IFRS 13.

Accordingly, the fair value of a financial asset is to be calculated as the quoted price of that financial asset in an active market multiplied by the quantity held (commonly referred to as 'P times Q'). This would continue to be the case even in times of significant market volatility.

What factors should be considered in estimating the value in use for investments in subsidiaries, associates and joint ventures?

If dividend discount model is used:

- Expected dividends and growth shall be adjusted to reflect the potential impact of COVID-19 on the amount, timing and ability of the investee to declare dividends in the future.
- Since the risk-free rate is generally low, adjustments to the cost of equity for size, liquidity (if appropriate), volatility and other company or investment specific risks shall be added in estimating required return.

If the DCF approach is used:

- The forecasts should consider the wide range of potential impact of COVID-19 on the business, including changes in consumer demand, competition, working capital and financing requirements, and medium-to long term growth of the business.
- Scenario analysis for the worst, base and best cases should be considered to estimate the range of potential impact of the outbreak on the company's expected cash flows. value chain and medium to long term growth rates.
- The weighted average cost of capital shall also be adjusted to consider any change in the credit rating or borrowing cost, and other risk premium specific to the investee.

C. Valuation approach and technique(s)

When determining the fair value of an asset or a liability, an entity selects those valuation techniques that are appropriate in the circumstances and for which sufficient data is available to measure fair value. The technique used should maximise the use of relevant observable inputs and minimise the use of unobservable inputs. IFRS 13. 61

IFRS 13 does not establish requirements for specific valuation technique(s) to be used unless there is a quoted price in an active market for an identical asset or liability. In some cases, only a single valuation technique will be appropriate to assess fair value, in other cases, however, using more than one valuation technique will be more appropriate. IFRS 13. 63

IFRS 13 refers to a valuation as a broad-based category of techniques whereas a 'valuation technique' refers to a specific technique such as a particular option pricing model. Valuation techniques used to measure fair value fall into three approaches (IFRS 13.62):

- Market approach
- Income approach
- Cost approach

What to think about:

Is the current valuation approach and technique relevant?

Companies should use valuation policies and approaches that are already in place and the underlying requirement of IFRS 13 to maximize the use of relevant observable inputs and minimize the use of unobservable inputs. IFRS 13 indicates that valuation techniques should be applied consistently while acknowledging that changes may be warranted if the change results in a measurement that is equally or more representative of fair value in the circumstances.

However, companies should consider which valuation technique is most appropriate in the current environment impacted by COVID-19.

What to consider when measuring fair value using a valuation technique?

Some of the key factors and risks to consider when measuring fair value using a valuation technique include the following:

- **Economic activity levels.** Measures taken to contain the virus may lead to a significant reduction in economic activity in terms of production of and demand for goods and services, and may have a negative impact on forecast future cash flows used in a discounted cash flow valuation method.
- **Credit risk and liquidity risk.** The uncertain economic environment has resulted in increases in credit risk and liquidity risk for many companies. Own credit risk and/or counterparty credit risk used as inputs into valuation techniques may therefore increase.
- **Forecasting risk.** Fair value measurements should reflect the greater uncertainty in making economic and financial forecasts in the near term, due to the difficulty in forecasting the magnitude and duration of the economic impact of COVID-19.
- **Foreign exchange risk.** Companies with significant sales or purchases in foreign currencies may be adversely affected by exchange rate movements.
- **Commodity price risk.** Companies in extractive industries may be significantly affected by decreases in commodity prices. Companies in countries that are economically dependent on these commodities may also have greater risk of adverse economic impacts.

Significant judgment may be needed to quantify risk premiums and other adjustments for these risks. Also, the number of fair value measurements classified as Level 3 in the fair value hierarchy may increase (e.g. due to unobservable inputs such as the credit risk becoming significant in the current environment).

D. Disclosures

IFRS 13 requires an entity to disclose information that helps users of its financial statements assess both of the following: [IFRS 13:91]

- For assets and liabilities that are measured at fair value on a recurring or non-recurring basis in the statement of financial position after initial recognition, the valuation techniques and inputs used to develop those measurements.
- For fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period.

What to think about:

Interim reports

IAS 34 Interim Financial Reporting requires companies to provide many of the IFRS 13 disclosures on fair value measurement of financial instruments, including the sensitivity disclosures and significant transfers between levels in the fair value hierarchy. Additionally, IAS 34 requires companies to explain events and transactions that are significant to an understanding of the changes in a company’s financial position and performance since the last annual reporting date. Therefore, fair value disclosures related to non-financial assets and non-financial liabilities are required if they are material to an understanding of the current interim period. This may be the case when fair values change significantly. [IAS 34.15, 16A(j)].

Annual reports

Given the impact of the increase in economic uncertainty on forecasting cash flows and other unobservable inputs used in valuation techniques (e.g. certain risk-adjusted discount rates), companies may need to provide sensitivity disclosures - together with disclosure of the key assumptions and judgements made by management - to enable users to understand how fair value has been determined. These disclosures are required under both IFRS 13 Fair Value Measurement and IAS 1 Presentation of Financial Statements. IFRS 13 also contains specific disclosure requirements when amounts are transferred into Level 3 of the fair value hierarchy, including sensitivity disclosures.

For fair value measurements categorised within Level 2 and Level 3 of the fair value hierarchy, company should provide a description of the valuation technique(s) and the inputs used in the fair value measurement, any change in the valuation techniques and the reason(s) for making such change.

2. For Business

Financial statement presentation

The impact of COVID-19 on the accounting for the business will be dependent on each entity's specific facts and circumstance.

- Consider whether:
    - Valuation reflects market participants' assumptions based on information available and market conditions at the measurement date; and
    - Consider whether valuation incorporates the risk premiums that would arise from the increased uncertainty and other impacts of COVID-19.
- Consider whether unobservable inputs have become significant, which would result in a Level 3 categorisation and require additional disclosures.
- Consider expanding disclosures about the key assumptions, sensitivities and major sources of estimation uncertainty.

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Section 5: Impairment of Non-Financial Assets (IAS 36)

Impairment of Non-Financial Assets (IAS 36)

1. Introduction

The outbreak of COVID-19 and the impact on the wider economy is placing unprecedented pressures on communities and businesses. Near term business priorities and focus will be on liquidity and potential going concern issues. However, attention also needs to be paid to the value of balance sheet assets and the requirement to consider if these are impaired. This is a question regardless of industry sector, but particular attention should be paid to those entities that have large property, plant and equipment ("PP&E") balances or material goodwill and/or intangible assets. Assessments made about the impairment of such assets a few months ago may no longer be valid. At the very least, they will need to be reconsidered in light of the COVID-19 pandemic and the potential impact this will have on all businesses.

IAS 36, Impairment of Assets applies to following assets recognised in an entity's financial statements:

- Goodwill;
- Intangible assets;
- Property, plant and equipment;
- Right-of-use assets;
- Associates and joint ventures accounted for under the equity method;
- Investment properties not measured at fair value; and
- Costs to obtain or fulfil a contract recognised in accordance with IFRS 15, after the impairment requirements of IFRS 15.101-103 have been applied.

A. Indicators of impairment

IAS 36 requires goodwill and indefinite-lived intangible assets to be tested for impairment at least annually and other non-financial assets when there is an indication of possible impairment (a triggering event). It provides examples of indicators of triggering events, including:

- When significant changes have taken place during the period (or will take place in the near future) in the market or in the economic environment in which the company operates and these changes will have an adverse effect on the company; and
- When the carrying amount of the company's net assets is higher than its market capitalisation. [IAS 36.9–10, 12].

The impacts of COVID-19 have caused a significant deterioration in economic conditions for many companies, and an increase in economic uncertainty for others, which may constitute triggering events.

- Certain sectors have been significantly impacted - e.g. travel, tourism, entertainment, retail, construction, manufacturing, insurance and education.
- Companies in extractive industries may also have been significantly affected by decreases in commodity prices and companies in countries that are economically dependent on these commodities may also be exposed to a greater risk of adverse economic impacts.
- Certain types of investment properties (and right-of-use assets arising from leased real estate) - e.g. retail and industrial properties - may be considerably affected by COVID-19. Tenants that have been forced to suspend operations may not be able to pay rent in the near term or may ask to renegotiate a lower rent. They may also become less creditworthy. Similar considerations would also apply for companies that lease assets (e.g. aircraft and shipping vessels) to the transport sector.

What to think about:

The following impairment indicators might be particularly relevant in the current economic climate:

- Actual financial performance is significantly lower than the original budget;
- Cash flow is significantly lower than earlier forecasts;
- Material changes in mid-term and/or long-term growth rates as compared to the previous estimates;
- Market capitalisation less than book value of net assets;
- Announced change in business model, restructuring, discontinued operations, etc;
- Restrictions on operations such as inability to import, export, or travel;
- Increase in the entity's cost of capital;
- Change of market interest rates or other market rates of return;
- Fluctuations in the foreign exchange rates or commodity prices that impact the entity's cash flows;
- Deferral of investment projects; and
- The carrying amount of net assets of an entity exceeding its market capitalisation. This list is not comprehensive and other indicators might present themselves. The indicators above and in the standard are examples only.

Impairment considerations for Lessees

The principles and procedures of IAS 36 that apply to impairment of other non-financial assets apply equally to the ROU assets. Generally, ROU assets is tested for impairment as part of the larger GCU to which it relates. However, a ROU asset that meets the definition of Investment Property and is measure at cost is tested for impairment separately because it generates independent cash flows.

ROU assets that meet the definition of Investment Property and are measured at fair value are excluded from the scope of IAS 36.

Under IFRS 16, a lessee can choose not to apply the ROU model to some leases - i.e. short-term leases and leases in which the underlying asset is of low value. For these leases, the lessee includes the future lease payments in the cash flow forecasts when calculating the CGU's recoverable amount (IFRS 16.5).

Impairment considerations for Lessors

For operating leases, a lessor includes the underlying leased asset in the carrying amount of the CGU and applies IAS 36. The lessor includes the future cash receipts in its cash flow forecasts. In addition, the company applies IFRS 9 to test lease receivables for impairment.

B. Determining the recoverable amount (cash flows and discount rates)

Recoverable amount is the higher of an asset's fair value less costs of disposal and its value in use. This reflects the greatest value of an asset in terms of the cash flows that can be derived from it, either by selling it or by continuing to use it in the business. [IAS 36 para 6].

What to think about:

Challenges in estimating cash flows

Estimating future cash flows could be particularly challenging for many companies due to the increase in economic uncertainty.

- Under value in use ("VIU"), the cash flow projections should be based on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of the asset or CGU. Greater weight is given to external evidence. [IAS 36.33(a)]
- Under fair value less costs of disposal ("FVLCD"), the estimates and assumptions used are from the perspective of market participants. [IFRS 13.22]

As such, the following should be carefully considered:

- The assumptions and cash flow forecasts used to test for impairment should be updated to reflect the potential impact of COVID-19;
- 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;

Due to the high degree of uncertainty and resulting challenges in forecasting cash flows, it could be helpful to base those forecasts on external sources such as economic projections by respected central banks and other international organisations.

To cushion the economic and financial market impacts, governments in certain regions and international organisations have committed to fiscal stimulus, liquidity provisions and financial support. Companies will need to understand the terms and status of these provisions and consider what impact they might have on their cash flow projections.

Reflecting risks in the discount rate

COVID-19 might have a significant impact on the risk-free rate and on entity-specific risk premiums (e.g. financing risk, country risk and forecasting risk) used in determining the appropriate discount rate to discount future cash flows. [IAS 36.A1, A16, A18]

The risk-free rate is generally based on the yield on government bonds that have the same or similar duration as the cash flows of the asset or CGU. In certain jurisdictions, the yield on long-term government bonds has decreased in the first quarter of 2020. However, a decrease in the risk-free rate following a decrease in the yield on government bonds may not translate into declines in a company's discount rate due to possible increases in credit and/or other risk premiums in the company's circumstances.

Considering the approach to projecting cash flows

Given the uncertain macroeconomic outlook, with scenarios ranging from economic disruption for a few months before economic activity returns to normal, through to a lengthy period of disruption triggering a significant recession, estimation uncertainty will be significantly higher than normal and there will probably be a wider range of reasonably possible cash flow projections.

Two approaches can be used to project cash flows:

- The traditional approach, which uses a single cash flow projection, or most likely cash flow; and
- The expected cash flow approach, which uses multiple, probability-weighted cash flow projections. [IAS 36.A4–A14]

Given the high degree of uncertainty, it may be helpful to consider using an expected cash flow approach as opposed to the traditional approach. Under the traditional approach, cash flows are not adjusted for risk but, rather, risk is reflected in determining the discount rate. Under the expected cash flow approach, the uncertainty about the future cash flows is reflected in the different probability-weighted cash flow projections used, rather than in the discount rate. The expected cash flow approach inherently requires a more explicit consideration of the wider than normal range of possible future outcomes. [IFRS 13.B26, IAS 36.A7]

Whichever approach a company adopts, the rate used to discount cash flows should not reflect adjustments for factors that have been incorporated into the estimated cash flows and vice versa. Otherwise, the effect of some factors will be double counted. [IAS 36.55–56]

C. Disclosures

In the context of impairment testing of goodwill and indefinite-lived intangible assets, IAS 36 requires disclosure of the key assumptions used to determine the recoverable amount. It also requires sensitivity disclosures if a reasonably possible change in a key assumption would cause the CGU's carrying amount to exceed its recoverable amount. Furthermore, IAS 1 Presentation of Financial Statements requires disclosure of the key assumptions that a company makes about the future and other major sources of estimation uncertainty at the reporting date that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities in the next financial year. [IAS 1.125, 129, 36.134(d)–(f)]

What to think about:

Interim condensed reports

IAS 34 Interim Financial Reporting requires disclosure of the nature and amount of changes in estimates. Impairment losses are examples of events and transactions that require disclosure under IAS 34 if they are significant. As noted in IAS 34, when an event or transaction is significant to an understanding of the changes in an entity's financial position or performance since the last annual reporting period, as may be the case with material impairment losses recognized in an interim period, the company's interim financial report should provide an explanation of and an update to the relevant information included in the financial statements of the last annual reporting period. IAS 36 provides relevant disclosures to be considered in this regard. [IAS 34.15B(b), 15C, 16A(d)].

Annual reports

Because the uncertainty associated with management's assumptions about the future is likely to be significant, it is important that management develops robust disclosures to help users understand the degree of estimation uncertainty that exists in estimating the recoverable amount and the sensitivity of the recoverable amount to reasonably possible changes to key assumptions. For example, it may be appropriate to disclose management's views about the degree of uncertainty associated with the macroeconomic outlook (such as the severity and duration of the impact that COVID-19 is expected to have on the company's business) and/or the potential significance of disruption to the supply chain, factory shutdowns, fall in demand etc.

2. For Business

Impairment considerations

- Consider whether there are any indicators of impairment for the company's CGUs (including ROUs, if applicable) or assets that are tested on a stand-alone basis. In particular, assess:
    - The impact of measures taken to contain COVID-19 on the company's business; and
    - Whether net assets exceed market capitalisation.
- Consider whether budgets and cash flow projections reflect the following to the extent applicable to the company, based on information available at the reporting date:
    - Projections of central banks and other international organisations about the duration and severity of the impact of COVID-19;
    - Supply of and demand for the CGU's products or services;
    - The decline in economic activity;
    - The impact of restrictions on transport, travel and quarantines;
    - The impact of exchange rates and commodity prices; and
    - The fiscal stimulus, liquidity provision and financial support from the state or international organisations.
- Consider whether discount rates used in recent valuations have been updated to reflect the risk environment at the reporting date.
- Consider enhancing sensitivity disclosures and disclosures about the key assumptions and major sources of estimation uncertainty in the interim and annual reports.
- Assess whether any onerous contract provision need to be considered.

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Section 6: Provisions and Contingencies (IAS 37)

IAS 37 - Provisions, Contingent Liabilities and Contingent Assets (IAS 37)

1. Introduction

The COVID-19 coronavirus outbreak has impacted many companies adversely - e.g. affecting their production processes, disrupting their supply chains, causing labour shortages and leading to closures of stores and facilities. Management may consider downsizing or discontinuing specific operations; conversely, some companies may plan to explore a new business opportunity. All of these may lead to a restructuring.

Some existing purchase or sale contracts may become loss-making due to COVID-19 and require a provision. Furthermore, companies may struggle to fulfil legal or contractual obligations and may be subject to penalties - e.g. for delays or non-performance - also resulting in a provision.

Entities often enter into insurance policies to reduce or mitigate the risk of loss arising from business interruption or other events.

The above may result in a variety of accounting implications which have been set out for consideration below:

- Restructuring provisions
- Onerous contracts
- Penalties
- Contingent assets

IAS 37 requires a provision to be recognised only where: an entity has a present obligation; it is probable that an outflow of resources is required to settle the obligation; and a reliable estimate can be made. IAS 37 does not permit provisions for future operating costs or future business recovery costs. IAS 37 requires an entity to disclose the nature of the obligation and the expected timing of the outflow of economic benefits.

- Impairment requirements of IFRS 15.101-103 have been applied.

A. Restructuring provision

Under IAS 37 specific guidance is provided for restructuring provisions. A restructuring provision is recognised only when both of the following conditions are met:

- There is a detailed formal plan for the restructuring; and
- A company has raised a valid expectation in those affected that the plan will be implemented - i.e. either by starting to implement the plan or announcing its main features to those affected. [IAS 37.72]

What to think about:

- For example, suppose a company decides to close down one of its production facilities as a result of COVID-19. If the company announces its plan, specifying the facility to be closed, the estimated timing of the closure and the approximate number of employees it plans to make redundant, then it recognises a restructuring provision. The approval of the restructuring plan by the company's board is not by itself sufficient to recognise a restructuring provision. [IAS 37.75]

Termination benefits for employees made redundant as part of the restructuring are recognised in accordance with the specific requirements of IAS 19 - Employee Benefits [IAS 19] and is not addressed in this guidance.

B. Onerous contracts

Onerous contracts are those contracts for which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. Unavoidable costs under a contract are the least net cost of exiting the contract (that is, the lower of the cost to exit or breach the contract and the cost of fulfilling it).

What to think about:

- A sales contract may become onerous if costs rise or are expected to rise - e.g. because the company needs to stop production, find an alternative supplier or hire additional employees. A sales contract may also become onerous if benefits are expected to be lower - e.g. because a fall in demand affects the pricing. When assessing the unavoidable costs, companies should consider the contract terms carefully, including termination and force majeure clauses.
- When preparing projections of costs and benefits for the onerous contract test, a company needs to reflect expectations at the reporting date and use assumptions that are consistent with those used for other recoverability assessments - e.g. impairment of non-financial assets. As the situation surrounding COVID-19 is rapidly changing, a company may need to update projections it made before the reporting date to reflect the information available, conditions and outlook at the reporting date.
- The provision for an onerous contract is discounted if the effect of the time value of money is material. Central banks in many countries are cutting interest rates in response to increasing concerns about the economic impact of COVID-19; this in turn may impact risk-free rates, which are often used to discount provisions. Companies need to update the discount rate if it has changed.

C. Penalties

Under IFRS Standards, if a company has a present obligation, which cannot be avoided and is expected to result in the outflow of economic resources, then it recognises a provision if the amount can be estimated reliably.

What to think about:

- Companies need to review their existing contracts and consider the interpretation of applicable law, particularly force majeure clauses, to determine whether they have an obligation triggered by COVID-19.
- In some cases, this may require them to recognise additional provisions - e.g. for failure to comply with applicable laws and regulations. Conversely, in some countries the outbreak may be regarded as force majeure and penalties for non-performance, late delivery or cancellation may be waived. This assessment may require legal advisors to be involved.

D. Contingent assets

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

What to think about:

- One of the steps taken to control the spread of the virus is to require some businesses to close temporarily. An entity might have business continuity insurance and be able to recover some or all of the costs of closing.
- The benefit of such insurance is recognised when the recovery is virtually certain. This is typically 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 often recognised later than the costs for which it compensates.
- Netting off is not allowed in the statement of financial position, with any insurance reimbursement asset classified separately from any provision. However, the expense relating to a provision can be shown in the income statement net of any corresponding reimbursement.

2. For Business

The impact of COVID-19 on the financial instrument impairment will be dependent on each entity's specific facts and circumstance. For ECL, business should consider:

A. Restructuring provisions

- Consider whether the plan (or need for a plan) to restructure triggers impairment of assets and perform the impairment test if necessary.
- Ensure that a formal detailed restructuring plan is in place, and that those affected by the plan have a valid expectation that it will be carried out, before recognising a restructuring provision.
- Provide clear and transparent disclosures about the nature of the restructuring provision, the expected timing of any resulting outflows of economic benefits and related uncertainties. [IAS 1.98(b), 125, 37.85(a)–(b)]

B. Onerous contracts and penalties

- Review termination clauses in key purchase and sales contracts to determine whether the cost of exiting a contract is lower than the cost of fulfilling it. Consider if COVID-19 falls under the force majeure clause in your jurisdiction.
- Update projections of costs and benefits for the onerous contracts test. Ensure that the assumptions are consistent with projections made for other purposes - e.g. impairment analysis. Check whether the risk-free rate used to discount provisions has changed.
- Consider contracts for penalty clauses and where necessary involve legal experts.
- Provide clear and meaningful disclosures about judgements and estimates made in recognising and measuring provisions.

C. Contingent assets

- Management should consider whether the losses arising from COVID-19 are covered by its insurance policies.
- Careful analysis of the terms and conditions of an entity's business interruption policies is required due to the wide variety of terms relating to the nature and level of losses covered. Some policies covering lost revenue or operating margins that typically are measured over a longer term require comparisons with similar periods in prior years.
- Appropriate disclosures should be provided in the financial statement if the contingent assets are material.

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Section 7: Financial Statements Presentation (IAS 1)

Financial Statements Presentation (IAS 1)

1. Introduction

The financial statement disclosure requirements for entities directly and/or indirectly affected by the outbreak will vary depending on the magnitude of the financial impact and the availability of information. Because the outbreak may also result in obligations or uncertainties that an entity may not have previously recognised or disclosed, an entity also needs to consider whether to disclose additional information in the financial statements to explain the impact of the outbreak on areas that might include provisions and contingent assets/liabilities. This may result in disclosures not necessarily required by a specific IFRS standard.

The section on financial presentation does not address disclosures addressed in other areas of the document but merely some additional considerations that may be relevant for reporting the COVID-19 impacts.

A. Disclosures of judgements and estimates

The disclosures are required to be presented in a manner that helps users of financial statements to understand the judgements that management makes about the future and about other key sources of estimation uncertainty. The nature and extent of the information provided will vary according to the nature of the assumption and other circumstances. Examples of the types of disclosures that an entity is required to make include:

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

What to think about:

- When reporting in uncertain times, it is particularly important to provide users of the financial statements with appropriate insight into the entity's resilience in the face of the current uncertainty and to understand the key assumptions and judgements made when preparing financial information.

- Management should consider the specific requirements in IAS 1 to disclose significant accounting policies, the most significant judgements made in applying those accounting policies, and the estimates that are most likely to result in an adjustment to profits in future periods. All these disclosures might be different 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 non-financial assets might be subject to a material change within the next year.
- Management should consider areas discussed in the document and what areas significant judgements were used and what significant estimates. Disclosures should be provided for these areas in particular impairment of financial and non-financial assets, going concern assessments, contingent liabilities, contingent assets, restructuring provisions, onerous contracts, lease incentives and renewal options.
- Further, relevant judgements and assumptions might include the:
  - Availability and extent of support through government support measures that have been announced;
  - Availability, extent and timing of sources of cash, including compliance with banking covenants or reliance on those covenants being waived;
  - Duration of social distancing measures and their potential impacts.
- The disclosure provided about the key assumptions, including the sensitivity analysis based on a range of reasonably possible outcomes, should reflect the conditions at the reporting date. When key assumptions, or the range of reasonably possible changes to those assumptions, are affected significantly as a result of non-adjusting events after the reporting date, information about those changes, including an estimate of the financial effect, should be disclosed separately.

B. Disclosures of financial 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. [This is further discussed under the IFRS 7 section of the document]

What to think about:

- Additional disclosures about liquidity risk might be needed where the virus 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.

C. Current versus non-current

IAS 1 requires classification on the statement of financial position as current or non-current unless order of liquidity is used.

What to think about:

- The financial impact of the virus might cause some entities to breach covenants on borrowings, or it might trigger material adverse change clauses. This could result in loan repayment terms changing and some loans becoming repayable on demand. Management should consider whether the classification of loans and other financing liabilities between non-current and current is affected and, in extreme situations, whether the entity remains a going concern. Management should consider particularly the impact of any cross-default clauses. Management should also consider the effect of any changes in the terms of borrowings as a result of the circumstances described above, and it should treat waivers obtained after the reporting date as non-adjusting events.

2. For Business

The impact of COVID-19 on the accounting for the business will be dependent on each entity's specific facts and circumstance. Business should consider:

Financial statement presentation

- Business should carefully consider the judgements made and estimates and once identified make appropriate detailed and specific disclosures thereof.
- Disclosures of financial risk in light of COVID-19 would be very important and management should again ensure all disclosures are clear, concise yet informative and tailored to the organisations specific facts and circumstances.
- Disclosure of financial liabilities should be carefully considered by management.

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General Guidelines

Section 8: Revenue Recognition (IFRS 15)

Revenue Recognition: Disclosing Variable Considerations (IFRS 15)

1. Introduction

The coronavirus outbreak could affect estimates in ongoing customer contracts in the scope of IFRS 15 Revenue from Contracts with Customers. If the consideration promised in a contract includes a variable consideration (e.g. discounts, refunds, price concessions, performance bonuses and penalties), an entity is generally required to estimate, at contract inception, the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer. Given the current economic situation, caused by the coronavirus outbreak, the estimate of variable amount could be affected because the entities are required to update the estimate throughout the term of the contract to depict conditions that exist at each reporting date.

Companies need to consider carefully whether actions taken to respond to the COVID-19 outbreak result in additional variable consideration - e.g. incentives or concessions offered to customers. Additionally, if a company's supply chain or labour force is disrupted such that it cannot satisfy its obligations, then this could result in penalties that reduce the transaction price.

Companies need to reassess the estimated transaction price at each reporting date. The estimates at previous reporting period may not hold good at coming reporting period and as a result, entities will have to revise expectations about the amount of consideration to which it expects to be entitled, considering uncertainties that are resolved or new information about uncertainties related to the coronavirus outbreak.

The amount of variable consideration an entity can include in the transaction price is constrained to the amount for which it is highly probable that a significant reversal of cumulative revenue recognised will not occur when the uncertainties related to the variability are resolved. An entity's estimate of the constrained amount may be impacted significantly by COVID-19.

COVID-19 may impact the stand-alone selling price estimates significantly, either because observable selling prices change or because inputs to estimate techniques change. This may in turn affect the amount of revenue recognised as each good or service in the contract is transferred.

While updating the estimates, entities should also consider the requirements to disclose the judgements and changes in judgements that significantly affect the determination of the amount and timing of revenue. For example, an entity is required to disclose information about the methods, inputs and assumptions used for estimating variable consideration and assessing whether an estimate of variable consideration is constrained.

A. Estimating variable consideration

An entity shall estimate an amount of variable consideration by using either of the following methods, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled:

a) The expected value—the expected value is the sum of probability-weighted amounts in a range of possible consideration amounts. An expected value may be an appropriate estimate of the amount of variable consideration if an entity has a large number of contracts with similar characteristics.

b) The most likely amount—the most likely amount is the single most likely amount in a range of possible consideration amounts (i.e. the single most likely outcome of the contract). The most likely amount may be an appropriate estimate of the amount of variable consideration if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not). [IFRS 15.53]

What to think about:

- When a company uses an input method to measure progress - e.g. costs incurred as a percentage of expected total costs, especially in case of over time recognition of revenue (common in sectors such as real estate, construction, engineering, aerospace and defence) - it needs to estimate the total expected inputs that will be needed to satisfy the performance obligation. COVID-19 may impact project timelines if work cannot be completed to schedule. It may also push up the costs of key inputs.

  Companies need to ensure that the estimated progress and revenue recognised reflect the latest expectations. Any changes in this estimate are accounted for prospectively.

- An entity is required to choose between the expected value method and the most likely method based on which method better predicts the amount of consideration to which it will be entitled. That is, the method selected is not meant to be a 'free choice'. Rather, an entity must select the method that is best suited, based on the specific facts and circumstances of the contract.

- The selected method shall be applied consistently to each type of variable consideration throughout the contract term and updates the variable consideration at the end of each reporting period.

- It may be appropriate for an entity to use different methods (i.e., expected value method or most likely amount) for estimating different types of variable consideration within a single contract.

B. Disclosures

An entity shall disclose information about the methods, inputs and assumptions used for all of the following:

a) Determining the transaction price, which includes, but is not limited to, estimating variable consideration, adjusting the consideration for the effects of the time value of money and measuring non-cash consideration; and

b) Assessing whether an estimate of variable consideration is constrained. [IFRS 15.126(a)(b)]

What to think about:

- Entities needs to consider whether in reaction to the corona virus outbreak, additional incentives are to be provided to existing customer for current contracts in place. Also, entity's estimate of the constrained amount may be impacted significantly by COVID-19. For example, falling demand may impact whether customers will qualify for rebates or volume discounts. If yes, entities are required to disclose the judgments and updated estimates together with brief of information on revised estimates and judgments are based.

- Where entities are not able to satisfy performance obligation as a result of the corona virus outbreak, consider whether it results in penalties that would reduce the transaction price. If this is the case, the disclosure is required of the judgement applied in estimating the penalties and its impact on amount of revenue recognition.

- The corona virus outbreak, prompts entities to reassess the estimate of traction price at each reporting date for current contracts with customers and if there is any change compared to previous estimates, a disclosure is required of methods, inputs and assumptions used together judgments applied along with new information on which updated estimates are based.

2. For Business

The impact of COVID-19 on the accounting for the business will be dependent on each entity's specific facts and circumstance. Business should:

Revenue Recognition: Disclosing Variable Considerations

- Carefully consider the judgement applied in determining additional incentives or penalties to be provided to the existing customer as a result of the corona virus outbreak.
- Assess the appropriateness of key assumptions in determining revised estimate of variable consideration, including the constraint.
- When revenue is recognised over time using an input method, evaluate whether the progress towards satisfaction reflects the latest expected total inputs.
- Assess whether estimated stand-alone selling prices need to be updated.
- Assess whether the disclosures provided in the financial statements are sufficient for users to understand the revision to estimates transaction price made, judgment applied and its impact.

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Section 9: Government Grant (IAS 20)

Government Grant (IAS 20)

1. Introduction

In response to the coronavirus, recently, in many countries' governments, government agencies or similar bodies have introduced measures to assist entities. These measures include direct subsidies, reduction of public levies, rental reductions or deferrals, interest waivers and low-interest loans.

Government grants are transfer of resources to an entity in return for past or future compliance with certain conditions relating to the entity's operating activities. Such assistance has been available to businesses for many years, although the exact nature of such support will vary from country to country in the region and over time as governments and their priorities change. The purpose of government grants, which may be called subsidies, subventions or premiums, and other forms of government assistance is often to encourage a private sector entity to take a course of action that it would not normally have taken if the assistance had not been provided.

Whilst the benefit of a low-interest loan, which is one of the common benefits provided by governments in the region, would be accounted for under IFRS 9 and IAS 20, not all the relief measures mentioned above are accounted for as government grants. For example, rental reductions or deferrals may be accounted for under IFRS 16 Leases. Government assistance in the form of benefits that may impact a company's taxable profit or its income tax liability - e.g. tax reliefs for certain types of income, additional tax deductions, a reduced tax rate or an extended period to use tax losses carried forward - are generally accounted for under IAS 12 Income Taxes, not IAS 20. Accordingly, entities should analyse all facts and circumstances carefully to apply the appropriate relevant accounting standards. Further, the distinction between government grants and other forms of government assistance is important because the standard's accounting requirements only apply to former.

In this section, we will focus on the accounting for government grants under IAS 20.

A. Recognition and measurement

1. Under IFRS, government grants should be recognised only when there is reasonable assurance that the entity will comply with the conditions attaching to them; and the grants will be received. [IAS 20.7]

What to think about:

- In cases where the government has decided to give out special benefit to the COVID-19 affected entities, the entities can recognise government grants only when it is confirmed that they are 'eligible' to receive the benefits and that any 'conditions' attached to these benefits are met. In addition, as required by IAS 20.7, there should be reasonable assurance that the entity will comply with the attached conditions.

- The phrase 'reasonable assurance' is generally interpreted as being a high threshold which we would suggest implies a significantly higher probability that 'more likely than not'. Therefore, we would not expect an entity to recognise government grants before it was significantly more likely than probable that the entity would comply with the conditions attached to them and that the grants would be received.
- In cases where benefits are given to entities without any specified conditions, an asset can be recognised at the time when it is 'reasonably certain' that the grants will be received. Nevertheless, it is important to note that the receipt of a grant does not of itself provide conclusive evidence that the conditions attached to the grant have been, or will be, fulfilled.
- It is also important to identify the party receiving the government grant. IAS 20 provides no explicit guidance on determining which party receives a government grant. In many cases, it will be clear which party is the recipient of the grant, because there are only two parties. However, many of the government relief programmes, as a result of COVID-19, are targeted at supporting small or medium-sized businesses or individuals and, as a consequence, the government is using other entities (that is, intermediaries) to facilitate the distribution of the relief. Judgement will be required in some cases to determine whether the intermediary receives the government relief and should therefore apply IAS 20.

  If the intermediary controls the grant before it transfers to the final party, this indicates that the intermediary is the party that obtains the grant from the government, and it should therefore apply IAS 20. If the intermediary does not control the grant before it transfers to the final party, the intermediary would not apply IAS 20 to the transaction. The intermediary might still need to recognise other assets or liabilities related to the arrangement in order to comply with other IFRSs.

  An entity controls an economic resource if it has the present ability to direct the use of the economic resource and obtain the economic benefits that might flow from it.

- Transactions with governments that cannot be distinguished from the normal trading activities of a company are not government grants. For example, if a company supplies goods or services to a government that are an output of its ordinary activities, then it will generally apply IFRS 15 Revenue from Contracts to Customers. This will include accounting for revenue only when the contract existence criteria in IFRS 15 are met.

2. A government grant may take the form of a transfer of a non-monetary asset, such as land or other resources, for the use of the entity. In these circumstances it is usual to assess the fair value of the non-monetary asset and to account for both grant and asset at that fair value. An alternative course that is sometimes followed is to record both asset and grant at a nominal amount. [IAS 20.23]

   Direct cash assistance or subsidies will be measured at their fair value.

   However, government grants can take other forms. For example, when a government grant takes the form of a low interest government loan, the loan should be recognised and measured in accordance with IFRS 9 (at its fair value) and the difference between this initial carrying value of the loan and the proceeds received is treated as a government grant.

What to think about:

- While determining fair value of grant, the entities needs to consider the use of appropriateness of underlying assumptions and valuation techniques to calculate fair value. For example, in case of low-interest government loan, one of the key assumptions would be to determine the 'discount' rate. The guidance in IFRS 13 Fair value measurement has to be applied in determining fair value.

3. A Under IFRS, Government grants shall be recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate. [IAS 20.12]

In cases where a grant relates to expenses or losses already incurred, or for the purpose of giving immediate financial support to the entity with no future related costs expected to be incurred, the grant should be recognised in income when it becomes receivable.

What to think about:

- The entities would need to carefully evaluate the terms of grant to analyse the related costs the grant intends to compensate.
- For example, if the grant intends to compensate the loss of interest over a period of coming six months, the related grant should also be recognised, in income statement, over similar six months. On the other hand, if grant intends to cover the loss already incurred, for example, compensating the modification loss of a financial asset, the grant is recognised when it becomes receivable.

B. Presentation

Government grants related to assets, including non-monetary grants at fair value, shall be presented in the statement of financial position either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset. [IAS 20.24]

Grants related to income are presented as part of profit or loss, either separately or under a general heading such as 'Other income'; alternatively, they are deducted in reporting the related expense. [IAS 20.29]

What to think about:

- Government grants do not meet the definition of either revenue from contracts with customers [IFRS 15 para 6] or lease income. [IFRS 16 para 81]. The netting option in IAS 20 is written in the context of deducting the grant income from the related expense, thereby showing the net expense borne by the entity. It would not be acceptable to apply this approach, by analogy, to grants designed to support lost revenue, because this would result in the grant income being inappropriately classified (for example, within revenue from contracts with customers or lease income).
- Whatever method of presentation is adopted, the management would need to consider the appropriateness of presentation to the readers of the financial statements.
- The presentation approach should be applied consistently to all similar grants and appropriately disclosed.

C. Disclosures

Entities should disclose the following information regarding government grants:

a) The accounting policy, including the methods of presentation adopted in the financial statements;

b) A description of the nature and extent of the grants recognised and an indication of other forms of government assistance from which the entity has directly benefited; and

c) Unfulfilled conditions or other contingencies attaching to government assistance that has been recognised. [IAS 20.39].

What to think about:

- Entities would need to think about how to disclosure the information in the financial statements.
- A balanced and concise package of information in the financial statement would certainly help the readers of the financial statements to understand the nature of grant together with accounting followed.

2. For Business

The government, government agencies and / or regulators in each of the jurisdictions have announced various relief measures to mitigate the impact of COVID-19 on businesses. Some of these relief measures may have to be assessed from the perspective of government grants and accordingly apply the requirements of IAS 20. The government grant accounting for the business will be dependent on each entity's specific facts and circumstance. Business should:

Government Grant

- Monitor government actions and legislation to identify all assistance that may meet the definition of a government grant.
- Carefully analyse the terms of grants i.e. when entities become eligible for grant and what expense it intends to compensate. Also, determining whether IAS 20 should be applied depends on facts and circumstances of the specific measures implemented by the government, including government agencies and similar bodies.
- Determine who is the party receiving the grant by analysing the facts of the relief programs and assess who controls the economic resources and obtain the benefits from the flow of economic resources.
- Assess the appropriateness of key assumptions in determining fair value of grant in case of direct cash assistance or subsidies will be measured at their fair value.
- Develop accounting policies and procedures for government grants.
- Assess whether the disclosures provided in the financial statements are sufficient for users to understand the nature of grant and accounting followed including the accounting policies for government grants.

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Section 10: Leases (Amendments, Partial Disposal, etc) (IFRS 16)

Leases (Amendments, Partial or full termination and rent concessions) (IFRS 16)

1. Introduction

IFRS 16 - Leases became effective for annual periods beginning on or after 1 January 2019 replacing the existing lease standard and interpretation IAS 17 and IFRIC 4.

After initial recognition, lessees and lessors may amend the lease contracts resulting in lease modification. A lease modification is a change in the scope of a lease (including full or partial termination), or the consideration for a lease, that was not part of the original terms and conditions of the lease.

In assessing whether there has been a change in the scope of the lease, an entity considers whether there has been a change in the right of use conveyed to the lessee by the contract - examples of a change in the scope of a lease include adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term. A rent holiday or rent reduction alone is not a change in the scope of a lease.

In assessing whether there has been a change in the consideration for a lease, an entity considers the overall effect of any change in the lease payments. For example, if a lessee does not make lease payments for a three-month period, the lease payments for periods thereafter may be increased proportionally in a way that means that the consideration for the lease is unchanged.

If there is no change in either the scope of the lease or the consideration for the lease, then there is no lease modification.

If a lease is modified, the modified contract is evaluated to determine whether it is or contain a lease. If a lease continues to exist, lease modification can result in a separate lease or a change in the accounting for the existing lease (i.e., not a separate lease).

The COVID-19 pandemic has led to various negotiations between lessees and lessors for rent concessions that includes rental holidays, rental deferrals or rent reduction for a period of time, possibly followed by increased rent payments in future periods.

The above circumstances raised concern whether rent concessions result in lease modifications and the complexity in applying the existing requirements of IFRS 16. Applying the requirements in IFRS 16 for changes to lease payments, particularly assessing whether the rent concessions are lease modifications, and applying the required accounting, could be practically difficult in the current circumstances.

To address the above matter, IASB took up an urgent project and issued an amendment to IFRS 16 on 28 May 2020 to provide lessees that have been granted COVID-19 related rent concessions with practical relief, while still providing useful information about leases to users of the financial statements.

A. Lease modification

For a lease modification that is not accounted for as a separate lease, at the effective date of the lease modification a lessee shall:

a) Allocate the consideration in the modified contract applying paragraphs 13-16 of IFRS 16;

b) Determine the lease term of the modified lease applying paragraphs 18-19 of IFRS 16; and

c) Remeasure the lease liability by discounting the revised lease payments using a revised discount rate. The revised discount rate is determined as the interest rate implicit in the lease for the remainder of the lease term, if that rate can be readily determined, or the lessee's incremental borrowing rate at the effective date of the modification, if the interest rate implicit in the lease cannot be readily determined. [IFRS 16.45]

For a lease modification that is not accounted for as a separate lease, the lessee shall account for the remeasurement of the lease liability by:

a) Decreasing the carrying amount of the right-of-use asset to reflect the partial or full termination of the lease for modifications that decrease the scope of the lease. The lessee shall recognize in profit or loss any gain or loss relating to the partial or full termination of the lease.

b) Making a corresponding adjustment to the right-of-use asset for all other lease modifications. [IFRS 16.46]

What to think about:

- It is critical to determine whether changes to a lease contract is a lease modification or not under IFRS 16 as there are specific accounting requirements in IFRS 16 for a lease modification that results in separate lease or not a separate lease.
- If the change to lease contract is not a lease modification, then the lessee applies the requirement of paragraph 38 of IFRS 16.
- The lessee should also consider whether this event is an indicator which trigger an impairment test for its right of use asset.
- The modification of the lease requirement requires the remeasurement of the lease liability using a revised discount rate. The coronavirus outbreak has exacerbated market volatility and central banks in many jurisdictions are cutting interest rates. Assessing a revised discount rate may also require judgment in these circumstances.

B. COVID-19-related rent concessions (IASB amendment to IFRS 16)

On, 28 May 2020, the IASB issued an amendment to IFRS 16 Leases to make it easier for lessees to account for COVID-19-related rent concessions such as rent holidays and temporary rent reductions. The practical expedient exempts lessees from having to consider individual lease contracts to determine whether rent concessions occurring as a direct consequence of the COVID-19 pandemic are lease modifications and allows lessees to account for such rent concessions as if they were not lease modifications. It applies to covid-19-related rent concessions that reduce lease payments due on or before 30 June 2021.

- A lessee that makes this election shall account for any change in lease payments resulting from the rent concession the same way it would account for the change applying this Standard if the change were not a lease modification. [IFRS 16.46A]
- The practical expedient in paragraph 46A 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:
    a) 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;

b) Any reduction in lease payments affects only payments originally due on or before 30 June 2021 (for example, a rent concession would meet this condition if it results in reduced lease payments on or before 30 June 2021 and increased lease payments that extend beyond 30 June 2021); and

c) There is no substantive change to other terms and conditions of the lease. [IFRS 16.46B]

- If a lessee applies the practical expedient in paragraph 46A, the lessee shall disclose:

  a) That it has applied the practical expedient to all rent concessions that meet the conditions in paragraph 46B or, if not applied to all such rent concessions, information about the nature of the contracts to which it has applied the practical expedient; and

  b) The amount recognised in profit or loss for the reporting period to reflect changes in lease payments that arise from rent concessions to which the lessee has applied the practical expedient in paragraph 46A.

What to think about:

- The amendment applies to annual reporting periods beginning on or after 1 June 2020. Earlier application is permitted, including in financial statements not yet authorized for issue at 28 May 2020.
- A lessee shall apply COVID-19 - Related Rent Concessions retrospectively, recognizing the cumulative effect of initially applying that amendment as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of the annual reporting period in which the lessee first applies this amendment.
- The COVID-19 related amendment to IFRS 16 is an exemption not an exception and therefore it is optional.
- Not all the COVID-19 - related rent concessions fall within this amendment. The management will have to make a thorough analyses of the concession to whether it meets all three criteria given in IFRS 46B. These are further explained by IASB Board in IFRS 16. BC205D (a) to (c).
- While lessees that elect to apply the practical expedient do not need to assess whether the rent concession constitutes a modification especially those arising from the COVID-19 pandemic, lessees still need to evaluate the appropriate accounting for each concession as the terms of the concession granted may vary.
- The circumstances that give rise to rent concessions as a result of COVID-19 pandemic are likely to indicate that assets may be impaired. For example, loss of earnings during the period covered by rent concession may be a indicator of impairment of the related right-of-use asset. Similarly, longer-term effects of the COVID-19 pandemic could affect the expected ongoing economic performance of right-of-use assets.
- COVID-19 is not an event that is under the control of the lessee. Therefore, COVID-19 by itself does not lead to a reassessment of the lease term. However, COVID-19 lockdown might lead the lessees to revise its business plans and commercial strategy, and to undergo a detailed review of its lease portfolio in the context of this revision. This is a significant event or a significant change in circumstances that is within the control of the lessee. If, as a result of this commercial strategy revision, the retailer concludes that it is no longer reasonably certain to exercise the extension option, it must reassess the lease term and the accounting is as per IFRS 16.39 and IFRS 16.40.

Payments received by lessees

When payments are received by a lessee, it is necessary to evaluate whether IFRS 16 applies to such payments. In some jurisdictions, local authorities have implemented policies to provide subsidies to lessees and others in order to support the local economy and these payments are accounted for under IAS 20. This is further detailed under the Government Grant section of this document.

When IFRS 16 applies to such payments made by a lessor, the lessee and lessor need to evaluate if there is a lease modification by considering the original terms and conditions of the lease. For example, a lessor may make a payment to a lessee of retail space in an airport when there are significant flight cancellations and such payment is not contemplated within the terms of the original contract (arising from an event such as the COVID-19 pandemic). In assessing whether the lease is modified, entities need to carefully evaluate terms of their contracts, including any force majeure clauses, which may, in specified circumstances, suspend some of their obligations or provide additional rights in the lease.

Where the payments received by lessee is not contemplated in the contractual terms of the original lease contract, the lessee accounts for lease modification by reallocating the consideration in the contract, reassessing the lease term, remeasuring the lease liability using a revised discount rate and making a corresponding adjustment to the right-of-use asset. However, when payments received by the lessee is contemplated under the terms and conditions of the lease, the accounting treatment would depend on specific facts and circumstances.

Lease modifications - Lessor perspective

Lessor accounting for lease modifications depends on the classification of the lease. A lessor accounts for a modification to an operating lease as a new lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as a part of the lease payments for the new lease. For a modification to a finance lease that is not accounted for a separate lease, the lessor accounts for the lease modification as new lease from the effective date of the modification and measures the carrying amount of the underlying asset as the net investment in the lease immediately before the effective date of the lease modification if the lease had been classified as an operating lease. Otherwise, the lessor applies the requirements of IFRS 9 to the modification to a finance lease that is not accounted for as a separate lease.

Paragraph 81 of IFRS 16 requires a lessor to recognise lease payments from operating leases as income on either a straight-line basis or another systematic basis. IFRS 16 does not specify a collectability criterion that must be met in order for a lessor to recognise operating lease income. A lessor could therefore continue to recognise operating lease income. However, a lessor is required to apply IFRS 9's impairment requirements to lease receivables. Impairment losses on lease receivables should be recognised separately as an expense.

The IASB amendment on 28 May 2020 applies only for lessees and the lessor accounting remains same and no accounting relief has been provided. Some accounting considerations for lessors, in current circumstances, could be arising from;

a) Reduction of lease payments for a particular month because of force majeure clause or applicable law or regulation,

b) Lessor voluntarily grants a short-term lease payment deferral for fixed lease payments that would otherwise be due, and

c) Lessor voluntarily forgives certain lease payments in advance of them being due.

Some practical application issues as a result of the recent IFRS 16 amendment on rent concessions are still under discussion.

2. For Business

The entities could be either lessee or lessor. As the accounting differs for lease modifications between a lessee and a lessor, especially when the lease contracts are modified due to COVID-19 it is important for the businesses to understand the accounting implications after considering the recent IASB amendment on rent concession. Business should:

Leases (Amendments, full or partial terminations, rent concessions)

- Carefully analyse the terms of rent concession i.e. whether rent concession is a COVID-19-related rent concession and fall within the recent amendment of IFRS 16.
- If there are substantive changes to the rent contracts then how those modifications are accounted in accordance with IFRS 16 as in such cases the practical expedient from the recent IASB amendment would not be applicable.
- Apply the transition requirements of recent IASB amendment in the correct accounting period.
- Consider whether there is an indicator which trigger impairment test for right of use asset due to lease contract modifications.
- Accounting implication varies whether payment received is a lease modification or not.
- Provide adequate disclosures in the financial statements with respect to lease modifications, the application of practical expedients, impact of such lease modifications etc. for better understanding of the users of the financial statements.

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Section 11: Changes in Estimates (Changes in Significant Accounting Estimates) (IAS 8)

IAS 8 - Accounting Policies, Changes in Accounting Estimates and Errors (IAS 8)

1. Introduction

Many items in financial statements cannot be measured with precision but can only be estimated. Since these accounting estimates arise from inherent uncertainties in business activities, a revision of an estimate may be required if the circumstances on which the estimate was based change, or if new information or experience is gained. On the other hand, change in accounting policy can occur if the change will result in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

Currently, the coronavirus 2019 (COVID-19) pandemic is affecting economic and financial markets, and virtually all industries are facing challenges associated with the economic conditions resulting from efforts to address it. As a result of the uncertainty associated with the unprecedented nature of the COVID-19 pandemic, entities are likely to face challenges related to selecting appropriate assumptions and developing reliable estimates. In most cases, entities need to apply changes in estimates due to changes in circumstances or conditions affecting the entity's financial position, financial performance or cash flows or as a result of latest available, reliable information.

Nevertheless, entities are still required by IFRS to develop estimates that underlie various accounting conclusions. To develop estimates, entities will need to consider all available information as well as whether they have met all applicable disclosure requirements, including those in IAS 1 Presentation of Financial Statements. A number of assumptions or estimates may be required for more than one purpose (e.g. forecast revenues may be relevant to impairment tests and recognition of deferred tax assets). Consistent assumptions should be used for all relevant assessments. IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors is applied in selecting and applying accounting policies, accounting for changes in estimates and reflecting corrections of prior period errors.

When reporting in uncertain times, it is particularly important to provide users of the financial statements with appropriate insight into the entity’s resilience in the face of the current uncertainty and to understand the key assumptions and judgements made when preparing financial information. Discussions on disclosure requirements for significant judgements, accounting estimates and sources of estimation uncertainty is covered under section financial statements presentation.

Accounting estimates arise from inherent uncertainties in business activities which mean that many items in financial statements cannot be measured with precision but can only be estimated. Estimates are formed using judgements based on the latest available, reliable information. Common examples of estimates in the financial statements include:

- Allowances for bad debts (covered under other document);
- Fair valuation of financial assets or financial liabilities (covered under other document);
- Impairment of non-financial assets (covered under other document);
- Revenue recognition - estimation of variable consideration (covered under other document);
- Warranty obligations (covered under other document);
- Lease rent concessions and lease term (covered under other document);
- Allowances for inventory obsolescence; and
- Useful lives, residual values and the expected pattern of consumption of the future economic benefits embodied in depreciable assets and intangibles’.

Accounting considerations

Changes in accounting estimates

The use of reasonable estimates is essential in the preparation of financial statements. A revision of an estimate may be required if the circumstances on which the estimate was based change, or if new information or experience is gained. The revision of an estimate does not relate to prior periods and is not equivalent to the correction of an error.

A change in an accounting estimate is "an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors".

It should be noted that a change in the measurement basis applied to an item in the financial statements constitutes a change in accounting policy, not a change in accounting estimate. In circumstances when it is difficult to distinguish between a change in an accounting policy and a change in an accounting estimate, the change is treated as a change in an accounting estimate.

Accounting for change in accounting estimates

The effect of a change in an accounting estimate is recognised prospectively by including it in profit or loss in:

a) The period of the change, if the change affects that period only (e.g. revision of a bad debts estimate); or

b) The period of the change and future periods, if the change affects both (e.g. revision of the estimated useful economic life of a depreciable asset).

To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, it shall be recognised by adjusting the carrying amount of the related asset, liability or equity item in the period of the change.

Prospective recognition of the effect of a change in an accounting estimate means that the change is applied to transactions, other events and conditions from the date of the change in estimate.

Presentation of effect of a change in accounting estimate

When a change in an accounting estimate is recognised in profit or loss, the change should be recognised in the same line item as the underlying item, except when a Standard requires a different treatment. For example, if the best estimate of a provision for a legal claim is reduced, the credit in profit or loss should be included within the same expense heading as the original expense was recognised. This ensures that the cumulative expense recognised under that heading is correct.

In addition, if the change in accounting estimate causes a material distortion in a particular expense heading, additional disclosure may be required in accordance with IAS 1:97 wherein when items of income or expense are material, an entity shall disclose their nature and amount separately.

Disclosure requirement for change in accounting estimates

An entity shall disclose the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods, except for the disclosure of the effect on future periods when it is impracticable to estimate that effect.

If the amount of the effect in future periods is not disclosed because estimating it is impracticable, the entity should disclose this fact.

Example of changes in accounting estimates

A. Allowances for inventory obsolescence

IFRS requirement:

The cost of inventories may not be recoverable if those inventories are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined. The cost of inventories may also not be recoverable if the estimated costs of completion or the estimated costs to be incurred to make the sale have increased. [IAS 2.28]

As such, it is required under IAS 2 Inventories to measure inventories at the lower of their cost and net realisable value (“NRV”).

What to think about:

- The COVID-19 pandemic may affect the recoverability of inventory balances. Some entities with inventories that are seasonal or are subject to expiration may have to assess whether a write-down for obsolescence or slow-moving stock may be necessary at an interim or annual period as a result of a slower sales pace. Other entities may have to assess whether a decline in their future estimated selling price is expected, which may require a write-down in the cost of inventory in an interim or annual period.
- In a difficult economic environment, the NRV calculation may be more challenging and require more detailed methods or assumptions. Interim inventory impairment losses should be reflected in the interim period in which they occur, with subsequent recoveries recognised as gains in future periods.
- Entities may have to reassess their practices for fixed overhead cost absorption if production volumes become abnormally low during the year as a result of plant closures or lower demand for their products. IAS 2 requires that variable production overhead costs should be allocated to each unit of production based on the actual use of the production facilities. It also calls for the allocation of fixed overhead costs to each unit of production based on the normal capacity of the production facilities. The COVID-19 pandemic may affect manufacturing entities in a number of ways (e.g. shortages of labour and materials or unplanned factory downtime) that, if sustained, may result in an abnormal reduction of an entity’s production levels. In such circumstances, an entity should not increase the amount of fixed overhead costs allocated to each inventory item. Rather, the unallocated fixed overhead costs are recognised in profit or loss in the period in which they are incurred.
- A new assessment is made of NRV in each subsequent period. When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in NRV because of changed economic circumstances, the amount of the write-down is reversed (i.e., the reversal is limited to the amount of the original write-down) so that the new carrying amount is the lower of the cost and the revised NRV.

B. Depreciation method, useful lives and residual value of depreciable assets and intangibles

IFRS requirement:

Under IAS 16 Property, plant and equipment, the factors considered in determining the useful life of an asset include:

- Expected usage of the asset. Usage is assessed by reference to the asset's expected capacity or physical output.
- Expected physical wear and tear.
- Technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset.
- Legal or similar limits on the use of the asset, such as the expiry dates of related leases.

Depreciation of an asset begins when it is available for use, ie when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 and the date that the asset is derecognised. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated. However, under usage methods of depreciation the depreciation charge can be zero while there is no production.

The residual value of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

The depreciation method, residual value and the useful life of an asset shall be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) shall be accounted for as a change in an accounting estimate in accordance with IAS 8.

IAS 38 Intangibles, has almost similar requirements for estimating depreciation method and residual value, while it has some additional factors in estimating useful life such as:

- Typical product life cycles for the asset and public information on estimates of useful lives of similar types of assets that are used in a similar way.
- The stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset.
- Expected actions by competitors or potential competitors.
- The level of maintenance expenditure required to obtain the expected future economic benefits from the asset and the entity's ability and intent to reach such a level.
- Whether the useful life of the asset is dependent on the useful life of other assets of the entity.

What to think about:

- As required in IAS 16, entities cannot stop depreciating an asset if it is idle unless if entities are using units of production method where the depreciation charge can be zero while there is no production.
- The depreciation method adopted for depreciable assets should be applied consistently from period to period and if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method shall be changed to reflect the changed pattern. For example where an entity is using the straight-line method of depreciation, it has determined that the economic benefits of the asset are consumed as a result of the passage of time. An entity would need to demonstrate that an asset is no longer consumed over time in order to change to a production method, which can be considered as a rare circumstance.

- Both for depreciable asset and intangibles, current circumstances may also require review of the estimates on useful lives and residual values as the underlying factors used to assess these can be significantly affected by changes brought about by COVID-19. Changes in useful lives and residual values estimates are expected to result to changes in depreciation or amortization expense, which will affect the entities revenue forecast, EBIT, loan covenant ratios and requirements, etc.

2. For Business

The impact of COVID-19 on the accounting for the business will be dependent on each entity's specific facts and circumstance. Further, entities need to ensure that controls and review process are in place to ensure that each assessment and change in estimates are considered on all relevant financial statements accounts, reviewed and approved by appropriate levels of management and supportable by reasonable information, analysis and calculations.

Businesses should also consider:

A. Allowances for inventory obsolescence

- Business, operating and marketing plans to recover the inventories. Sales and expense forecast may need to be updated given the current circumstances in order for the business to make more informed decisions.
- Once the NRV is assessed and the new carrying amount of inventories is determined, revisiting the cost per unit of its inventories and appropriately adjusting its sales per unit, according to the entities' business and marketing plans.

B. Depreciation method, useful lives and residual value of depreciable assets and intangibles

- Perform assessment whether the change in circumstances arising from COVID-19 would warrant a change in expected pattern of consumption of the future economic benefits of depreciable assets and intangibles.
- Update projections of depreciable asset's expected remaining capacity or physical output taking into consideration the potential technical or commercial obsolescence arising from the impact of COVID-19.
- Update estimate of the amounts that the entity will obtain from disposal of the asset.
- Once the revised useful life and residual value are re-assessed, determine potential impact areas of the business for e.g. on revenue forecast, EBIT, loan covenant ratios and requirements, etc. and perform relevant actions, where necessary.

Chapter I:

General Guidelines

Section 12: Subsequent Events (IAS 10)

Subsequent Events (IAS 10)

1. Introduction

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

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

A. Measurement

IAS 10 defines an adjusting event as an event that provides evidence of conditions that existed at the reporting date. A non-adjusting event indicates conditions that arose after the reporting date.

A material post balance sheet event requires changes in the amounts to be included in the financial statements where either of the following applies:

- It is an adjusting event (that is, an event that provides additional evidence relating to conditions that existed at the balance sheet date)
- The event indicates that it is not appropriate to apply the going concern basis of accounting [IAS 10 para 8].

Examples of adjusting events include:

- The settlement of a court case after the balance sheet date that confirms that the entity had a present obligation at the balance sheet date. The entity adjusts any existing provision for the obligation or creates a new provision.
- The receipt of information, after the balance sheet date, indicating that an asset was impaired as at the balance sheet date; for example, the bankruptcy of a customer that occurs after the balance sheet date that confirms that the customer was credit-impaired, or the sale of inventories after the period end that gives evidence about their net realisable value at the balance sheet date.

- The determination, after the balance sheet date, of the consideration for assets sold or purchased before the balance sheet date.
- The determination, after the balance sheet date, of profit-sharing or bonus arrangements, if the entity had a present legal or constructive obligation to make such payments as a result of events before the balance sheet date.
- The discovery of fraud or errors that show that the financial statements are incorrect. [IAS 10 para 9].

What to think about:

- Management might have judged that the impact of COVID-19 existed at the reporting date and should be incorporated into the measurement of assets and liabilities at the reporting date.
- An entity has to determine whether developments after the reporting date provide management with better information about a condition that already existed at the balance sheet date. [IAS 10 para 3].
- This requires judgement and an analysis of the facts and circumstances in order to distinguish between adjusting and non-adjusting information.
- The impairment test should be updated after the reporting date if material developments provide better information relating to the reasonably expected impacts of COVID-19 than existed at the reporting date.

B. Going concern

IAS 10 states that the financial statements should not be prepared on a going concern basis where events after the reporting date indicate that the going concern assumption is no longer appropriate. This guidance applies even if those events would otherwise be non-adjusting. Entities should therefore consider whether developments subsequent to the reporting date have any implications for the going concern assumption. [Please refer to going concern section - IAS 1.25]

What to think about:

- Management should assess the entity's ability to continue as a going concern at the time of preparing the financial statements. This assessment must cover the entity's prospects for at least 12 months from the balance sheet date considering the impact of COVID-19 even if events were post balance sheet.
- 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 will occur more than 12 months after the balance sheet date). [IAS 10 para 14].
- There could be significant uncertainty about whether the going concern basis of accounting is appropriate. Such uncertainty might arise because of post balance sheet events. Where material uncertainties cast doubt on an entity's ability to continue as a going concern, and its financial statements continue to be prepared on the going concern basis, full disclosure of the uncertainties is required. [IAS 10 para 16].

C. Disclosure

Disclosures related to conditions existing at the balance sheet date might need to be updated, to reflect new information received after the balance sheet date, even where no adjustments are required to the figures. [IAS 10 para 20].

If non-adjusting events after the reporting period are material, non-disclosure could influence the economic decisions that users make on the basis of the financial statements. Accordingly, an entity shall disclose the following for each material category of non-adjusting event after the reporting period:

a. The nature of the event; and

b. An estimate of its financial effect, or a statement that such an estimate cannot be made. [IAS 10.21]

What to think about:

- This disclosure should be transparent and specific to the entity, and it should include the nature of the event and an estimate of its financial effect.
- Entities should consider disclosing the impact of developments after the reporting date on the carrying amount of assets and liabilities (for example, the need to impair assets or remeasure fair values), or the impact on revenue or on borrowing covenants.

2. For Business

The impact of COVID-19 on the accounting for the business will be dependent on each entity's specific facts and circumstance. Business should consider:

Subsequent events

- Management need to continue to consider the impact of COVID-19 that existed at the reporting date and should be incorporated into the measurement of assets and liabilities at the reporting date.
- Careful consideration should be given at each reporting date as to whether entity is a going concern taking into consideration subsequent events even if not adjusting.
- Consider providing appropriate disclosures for the nature and impact of COVID-19 for non-adjusting events in particular.

Chapter I:

General Guidelines

Section 13: Interim Financial Reporting (IAS 34)

Interim Financial Reporting (IAS 34)

1. Introduction

Many entities might first report the impact of the virus in interim financial statements. The recognition and measurement guidance described in other areas of this document will also apply to interim financial statements. There are typically no recognition or measurement exceptions for interim reporting, although management might have to consider whether the impact of the virus is a discrete event for the purposes of calculating the expected effective tax rate. IAS 34, 'Interim financial statements', states that there might be greater use of estimates in interim financial statements, but it requires the information to be reliable and all relevant information to be disclosed.

Interim financial information usually updates the information in the annual financial statements. However, IAS 34 requires an entity to include in its interim financial report an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period. This implies that additional disclosure should be given to reflect the financial impact of the virus and the measures taken to contain it. This disclosure should be entity-specific and should reflect each entity's circumstances.

A. Disclosures

Interim financial information usually updates the information in the annual financial statements. However, IAS 34 requires an entity to include in its interim financial report an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period. This implies that additional disclosure should be given to reflect the financial impact of the virus and the measures taken to contain it. This disclosure should be entity-specific and should reflect each entity's circumstances. Where significant, the disclosures required by paragraph 15B of IAS 34 should be included, together with:

- The impact on the results, balance sheet and cash flows of the virus and the steps taken to control the spread;
- Significant judgements that were not required previously (for example, in connection with expected credit losses);
- Updates to the disclosures of significant estimates; and
- Events since the end of the interim period.

What to think about:

- IAS 34 includes a number of required disclosures as well as a non-exhaustive list of events and transactions for which disclosures would be required if they are significant. For example:
  - o Where significant, an entity needs to disclose changes in the business;
  - o Economic circumstances that affect the fair value of the entity's financial assets and financial liabilities, whether those assets liabilities are recognised at fair value or amortised cost;

- In addition, an entity is also required to disclose any loan default or breach of a loan agreement that has not been remedied on or before the end of the reporting period; and
- Transfers between levels of the fair value hierarchy used in measuring the fair value of financial instruments where significant.

- The standard presumes a user of an entity's interim financial report will have access to the most recent annual financial report of that entity.
- However, as most entities are only recently impacted by the outbreak which is rapidly evolving, they may not have included much relevant information in their last annual financial reports and thus may need to include more comprehensive disclosure on, especially, where relevant, the topics discussed in this publication for interim financial reporting purposes.

2. For Business

The impact of COVID-19 on the accounting for the business will be dependent on each entity's specific facts and circumstance. Business should consider:

Interim financial disclosures

- Consider whether information disclosed in the last annual financial statements remains relevant. If not, then provide updated disclosures.
- Assess whether the disclosures and explanations provided in the interim financial statements are sufficient for users to understand the significant events and transactions that have occurred since the annual reporting date.
- Provide additional disclosures to enable users of interim financial statements to understand the overall impact of the COVID-19 outbreak on the financial position and performance of the company.

Chapter II:

Industries Specific Guidelines

Section 14: Energy Industry
(Oil and Gas, and Utilities)

Section 14: Energy Industry (Oil and Gas, and Utilities)

Oil and Gas Industry

1. Introduction

Recent declines in worldwide crude oil and natural gas prices may create a number of accounting and disclosure implications for oil and gas entities. There may also be an effect on their suppliers, customers, lenders and others, who either directly or indirectly rely on or do business with entities in the oil and gas industry.

The outlook for prices in 2020 and beyond remains uncertain, due to factors that include; lack of agreement on production levels by members of OPEC and other oil and gas producing countries, effects of coronavirus pandemic, uncertainty about the future demand for oil and gas that predates the coronavirus pandemic due to factors such as the transition to cleaner energy.

This section provides insight into some important accounting considerations for entities in the oil and gas industry. While this section focuses on issues that are likely to be the most frequently encountered, many others are certain to arise. As the situation continues to evolve, so too will the consequential accounting issues. For these reasons, the following is not an exhaustive list of all relevant accounting considerations.

The following are key areas of consideration for oil and gas companies:

1) Revenue recognition;
2) Receivables and contract assets;
3) Inventories;
4) Impairment of non-current assets including Exploration & Evaluation (E&E) assets;
5) Restoration and decommissioning provisions;
6) Derivatives and hedging activities;
7) Commodity contract considerations; and
8) Going concern considerations.

2. Revenue recognition

The following three issues to be considered in application of IFRS 15: Revenue from Contracts with Customers by entities operating in oil and gas industry:

- Estimating variable consideration: Declines in crude oil and natural gas prices could affect revenue estimates in new and ongoing customer contracts that are within the scope of IFRS 15 Revenue from Contracts with Customers. This will be a concern, particularly for oilfield service, midstream and logistics entities, that have revenue contracts with upstream entities. This is because when a contract with a customer includes variable consideration (e.g., discounts, refunds, price concessions, performance bonuses and penalties), an entity is generally required to estimate, at contract inception, the amount of consideration to which it will be entitled in exchange for transferring promised goods or services. The amount of variable consideration an entity may include in the transaction price is constrained to the amount for which it is highly probable that a significant reversal of cumulative revenue recognised will not occur when the uncertainties related to the variability are resolved.
- Take or pay contracts: Entities also need to consider the impact on the amount and timing of revenue recognition in take or pay contracts for products, such as natural gas, where current conditions may mean the customer is not capable of taking delivery of the commodity.
- Modification of contracts: Declines in prices could also prompt entities to modify contracts with customers or reassess whether it is probable that the entity will collect the consideration to which it is entitled. As a consequence of COVID-19, which is contributing to the low oil price, oilfield services entities may find it more difficult to obtain payment for variation orders, and upstream, midstream and downstream entities may see customers invoke force majeure clauses (if applicable). Furthermore, entities may see customers wanting to invoke repricing clauses in long-term liquefied natural gas (LNG), natural gas or liquids supply contracts. If both parties to a contract agree to amend the scope or price (or both) of a contract, an entity accounts for the modification under the requirements in IFRS 15 and requires significant of judgement for example to determine an implied price concession to be accounted for as variable consideration or impairment loss on related receivables.

3. Trade receivables and contract assets

Majority of entities in oil and gas industry use the simplified approach for determining expected credit losses required under IFRS 9: Financial Instruments. In order to estimate expected credit losses, entities would need to consider reasonable and supportable forecasts of future economic conditions, in particular, entities should consider whether there is an increase in the probability that customers may be unable to repay their obligations when due. While forecasted economic conditions may not significantly affect credit loss estimates for short-term receivables and contract assets when the economy is stable, we believe affected entities need to challenge these assumptions in the current environment.

Slowdown of economic activities, due to Covid-19, may impact credit risk associated with receivables and contract assets and therefore may result in increase in expected credit losses.

If the payment terms are extended beyond normal credit terms, there is a need to determine whether this extension results in de-recognition of old receivables and recognition of new debt. If old receivables are continued to be recognised, it may result in modification losses, which has to be recognised fully at the time of modification.

4. Inventories

Inventories has become even more important in current economic time when there is a weak demand for oil and gas due to Covid-19. The situation is further deteriorated by decline in oil prices. All this may trigger the need for a lower of cost and net realisable value test for crude oil, natural gas and other commodity inventories. In determining the net realisable value of inventory, entities should be cognizant of rising storage costs as inventories of crude oil and refined products rise sharply, driven by a steep and sudden decline in demand.

Firm purchase commitments should be included in the inventory analysis, and entities should be aware of rising inventory levels because of take or pay contracts where the customer is not capable of taking delivery of the commodity. Inventory that has been designated as the hedged item in a fair value hedge would be assessed for impairment after hedge accounting has been applied for the period.

Entities carrying inventory at fair value (for example, commodity broker / dealers) also need to consider the potentially significant impact on the fair value measurement of such inventories.

5. Impairment of non-current assets including Exploration & Evaluation (E&E) assets

Current covid-19 situation mean impairment indicators may exist. Oilfield services entities may find that cancellations or delays in development plans of their customers mean that equipment carrying amounts may not be recoverable because of reductions in rates and current and future utilization.

Because of the steep decline in oil price there is a risk of reserves becoming uneconomic which might have consequential impacts for impairment outcomes.

Entities should carefully evaluate the appropriateness of inputs and assumptions used for impairment testing, especially long-term price and volume forecasts used for prospective information. Disclosure of the actual commodity prices used in the impairment analyses would be appropriate even if the entity does not have any goodwill or indefinite life intangibles.

There is a risk of reserves becoming uneconomic because of the steep decline in oil price. This may have consequential impacts for impairment outcomes and depreciation calculations.

Entities should also consider whether current economic conditions mean that there is not a reasonable expectation that E&E assets will be developed. An entity might not be able to continue with exploration for a variety of reasons, including factors such as inability to obtain necessary financing to continue exploration. Where indicators exist for E&E assets, they should be tested for impairment in accordance with IFRS 6 and IAS 36.

The recent declines in oil and gas prices could affect reserve reporting and disclosure. If material reserves volumes are derecognised, or classification of reserves change, an entity should consider the effects on depreciation, depletion and amortisation rates and impairment analyses.

More detailed information and consideration is included under Section 5 – Impairment of Non-Financial assets in the document.

6. Restoration and decommissioning provisions

Changes in estimates of 2P reserves and drilling plans, as well as the effect of pricing pressure on support services, may affect the timing, amount and probabilities of expected cash flows associated with plugging wells or decommissioning other oil and gas assets and associated infrastructure. This added uncertainty could affect the accounting for restoration or decommissioning provisions.

Changes in the certainty of the cash flows may lead to changes in probabilities assigned to expected cash flow scenarios when estimating asset retirement obligations. In addition, interest rates have been impacted by the current economic situation and this will likely result in changes to the discount rate applied to these obligations. Any corresponding increases in restoration and decommissioning assets arising from changes in the provision may lead to impairment triggers being present.

7. Derivatives and hedging activities

Entities with derivative instruments may experience substantial gains or losses on these instruments, which could affect collateral requirements and liquidity. Changes in a derivative counterparty's credit risk or an entity's own non-performance risk could also affect fair value estimates of derivatives and hedge effectiveness.

If the decrease in oil prices affects the probability of hedged forecasted transactions occurring during the time period designated at the inception of a hedge, an entity will need to determine whether it can still apply hedge accounting to the forecasted transaction or a proportion of it:

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

8. Commodity contract considerations

Oil and gas entities often enter into commodity contracts under long-term, non-cancellable agreements. To the extent that the entity is selling or purchasing volumes that are no longer required, these contracts might become onerous or they might be no longer be held for the entity's own use. Where purchases or sales contracts are net settleable in accordance with IFRS 9 and the entity is no longer holding such contracts for own use, they might need to be accounted for as derivatives measured at fair value through profit or loss in accordance with IFRS 9. In addition, entities should be on the lookout for contracts that have become onerous.

9. Going concern considerations

As a result of COVID-19 and its associated effects, entities need to consider whether, in their specific circumstances, they have the ability to continue as a going concern within one year after the date on which the interim or annual financial statements are issued (or available to be issued, when applicable). The initial assessment (before consideration of management's plans) will require an entity to consider, among other things, (1) the extent of operational disruption, (2) potential diminished demand for products or services, (3) contractual obligations due or anticipated within one year, (4) potential liquidity and working capital shortfalls, and (5) access to existing sources of capital (for example, available line of credit). An entity can only base this initial assessment on information that is available (that is, known and reasonably knowable) as of the issuance date of the financial statements. An entity may be able to alleviate substantial doubt, if it exists, if it is probable that its plans will be effectively implemented, and, when implemented, will mitigate the conditions that are raising substantial doubt in the first instance and will do so within one year after the issuance date of the financial statements.

Further, an entity must provide comprehensive disclosures in its annual and interim financial statements when events and conditions are identified that raise substantial doubt about the entity's ability to continue as a going concern even when management's plans alleviate such doubt.

More detailed information and consideration is included under Section 1 – 'Financial sustainability and Going Concern' in the document.

Utilities industry

The utilities industry is not as significantly impacted as the oil and gas industry from a financial reporting perspective. However, there are few areas where some accounting considerations are required and are as below:

A. Revenue

Utility entities in economies where businesses have curtailed or ceased operations, might experience a decline in the demand for their services. Additionally, there could be an impact on assumptions used in measuring revenue, including any expected price concessions or deferred payment plans which create a significant financing component.

Further, for the contract to exist, it must be probable (under IFRS 15) that the entity will collect the consideration to which it is entitled for transferring the goods and services to the customer. If a utility entity is required or choses to continue providing goods and services to a customer that is experiencing cash flow problems and there is significant doubt as to whether consideration will be collectible, it might not be appropriate to recognize revenue when the related goods or services are transferred to the customer.

B. Estimates of expected credit losses under IFRS 9

Utility entities are often required to provide services to both commercial and industrial customers across industries and retail customers who might be impacted to varying degrees by the pandemic. IFRS 9 requires entities to use an expected credit loss model for most financial assets, including trade receivables. Entities are required to apply simplified approach (lifetime ECL) for trade receivables which does not have significant financing component. The ECL model requires consideration of historical and current information, as well as reasonable and supportable forecasts of future conditions (including macroeconomic information). ECL is likely to increase as a result of pandemic. However, utilities should also consider the impact of any collateral (such as deposits) and government programmes designed to support customers in developing their provisions.

Refer to Section 2 - Impairment of Financial Assets in the document

C. Government relief programmes

Many governments are developing programmes to provide economic support. Where this intervention is made through the utility (for example, by providing funding to utilities in order to compensate for deferred payment plans), a key accounting consideration is whether an element of the transaction is government grant. This can impact the timing of recognition of the effect of the relief, the presentation of those effects and what disclosures might be required in accordance with IAS 20.

More detailed information and consideration on Government Grant is included under Section 9 of the document.

D. Impairment of non-financial assets

Typical to any asset heavy industries, utility entities have significant investment in property, plant and equipment which means there is a need to assess whether there are any indicators of impairment at the reporting date as required by IAS 36. With the recent developments of the pandemic, there are both external and internal sources of information, such as the fall in stock and commodity prices, decrease in market interest rates, manufacturing plant shutdowns, shop closures, reduced demand and selling prices for goods and services, etc., indicating that an asset may be impaired.

An asset is impaired when an entity is not able to recover its carrying value, either by using it or selling it. An entity estimates the recoverable amount of the asset for impairment testing.

Recoverable amount is the higher of the fair value less costs of disposal (FVLCD) and the value in use (VIU). Value in use is defined as the present value of the future cash flows expected to be derived from an asset or cash generating unit. The calculation of an asset's value in use incorporates an estimate of expected future cash flows and expectations about possible variations of such cash flows.

In cases where entities are receiving government grants in relation to the pandemic and these cash flows are part of the recoverable amount, entities should carefully consider the conditions of any government grant in order to assess whether the inclusion of such amounts in the impairment test is based on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of the asset or CGU.

More detailed information and consideration is included under Section 5 – Impairment of Non-Financial assets in the document.

Chapter II:

Industries Specific Guidelines

Section 15: Banking and Financial Services Industry

Section 15: Banking and Financial Services Industry

1. Introduction

The COVID-19 pandemic continues to put severe strain on people and businesses across the globe.

Banks are at the front-line of the economic disruption brought about by the COVID-19 pandemic. Central banks, large universal banks, small to medium-sized regional banks, fintechs, are all facing unprecedented challenges and risks. They are also taking multiple measures to support their employees and customers and help bolster the financial system.

There are numerous challenges that banks face due to COVID-19 which includes both financial risks and non-financial risk (“NFR”). Key challenges faced by the banks will be maintaining the liquidity, managing the credit risk and capital optimization. Borrowers and businesses face reduced sales and declining profits as the virus continues to spread around the world. Banking customers are likely to start seeking financial relief, and banking regulators are encouraging banks to help borrowers navigate the crisis.

2. Targeted Economic Support Scheme (“TESS”) by Central Bank UAE (“CBUAE”)

Globally, Central Bank actions have been decisive and far-reaching. In UAE, the CBUAE has introduced TESS scheme to support the sector. These measures are primarily focused on increasing the liquidity to enhance the credit flow in the economy. Following are some of the relief measures announced as part of the scheme:

- Access to additional funding to financial sector at zero cost against collateral by the CBUAE.
- Allowing banks to tap into a maximum of 60% of their capital conservation buffer, and those designated as systemically important banks will be able to use 100% of their additional capital buffer.
- Reducing the amount of capital requirements for loans extended to SMEs by 15 to 25%, to facilitate the sector’s access to financing.
- In addition, the existing limits which sets the maximum real estate exposure is being revised. Banks will be allowed to increase it to 30% of the banks’ loan portfolio (measured by risk weighted assets) subject to other capital compliance requirement.
- The purpose of this scheme is to facilitate provision of temporary relief from the payments of principal and interest on outstanding loans for all affected private sector companies and retail customers in the UAE. Participating banks should use the funding to grant temporary relief to private sector corporate customers and retail clients for a period of up to 6 months.

A joint guidance note was issued by CBUAE, ADGM and DIFC which provided guidance to banks on determining the impact of COVID-19 on ECL provisions in light of the IFRS 9 requirements.

- Link to joint guidance
- Link to CB notice

3. Accounting considerations

This section provides our insight into the top accounting issues that entities in the financial sector might face. While this section focuses on issues that are likely to be the most frequently encountered, many others are certain to arise. As the situation continues to evolve, so too will the consequential accounting issues. For these reasons, the following is not an exhaustive list of all relevant accounting considerations.

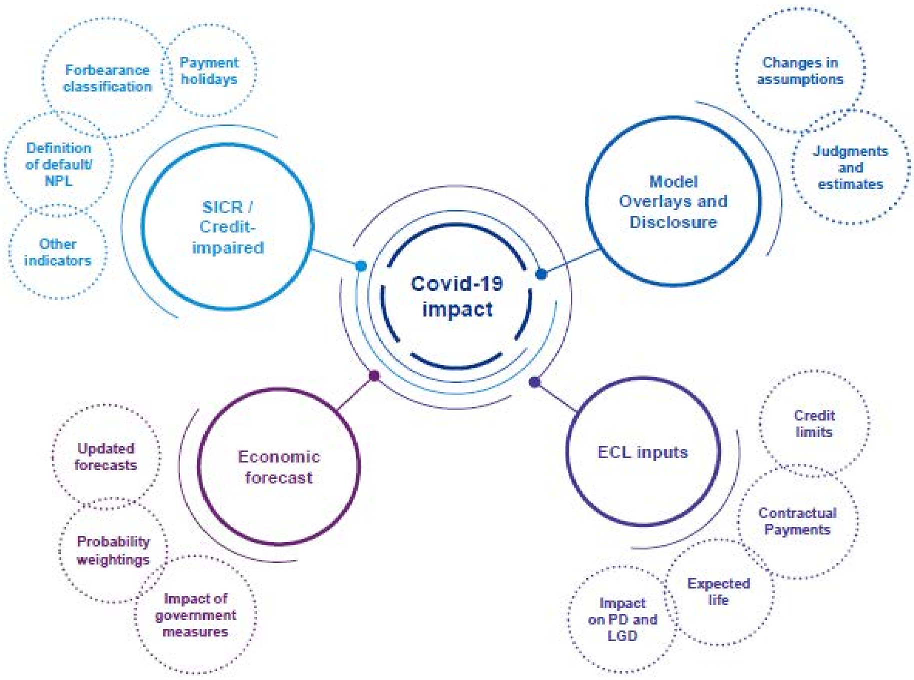
3.1. Expected credit loss ("ECL")

ECLs are an unbiased probability-weighted estimates that reflect reasonable and supportable information that is available without undue cost and effort at the reporting date. This includes information about past events, current conditions and forecasts of future economic conditions.

Therefore, in assessing economic conditions, an entity gives consideration both to:

- The direct effects of COVID-19 and government measures to contain it, which have led to big decreases in economic activity, employment and business confidence with a negative impact on credit conditions; and
- The significant government and other support measures being provided - which are intended to mitigate the negative impact.

Snapshot of COVID-19 impact on ECL computation under IFRS 9:



Significant increases in credit risk (“SICR”)

Below are some of the key issues that will have to be considered while identifying SICR in the context of COVID-19:

Banks will need to consider whether they can incorporate COVID-19-related changes in the risk of default into PDs for individual exposures on a timely basis. Identifying SICR is usually material for banks and other financial institutions. This is particularly relevant for exposures where banks calculate explicit probabilities of default (“PDs”) for individual exposures and use these to perform quantitative assessments of SICR.

- Banks also need to consider qualitative factors when identifying SICR. For example, changes in customer behaviour or requests for payment holidays or credit limit increases etc. may indicate SICR or credit impairment.
- Assessing the SICR may require significant judgement, both for the qualitative and quantitative assessment. Furthermore, it may involve changes in the risk management processes in the bank. Both would need to be appropriately disclosed.
- If a bank is not able to identify key drivers of credit risk on an individual instrument basis, then it may need to assess SICR on a collective basis. For example, it might need to consider whether, on the basis of the information available at the reporting date, credit risk has increased significantly for all or some borrowers in certain industries or regions and, if so, transfer all or a portion of those exposures to Stage 2 (or Stage 3 if they are credit-impaired).
- There is a rebuttable presumption that a SICR has arisen when contractual payments are more than 30 days past due. Should the company rebut this presumption in the light of COVID-19?

  It is possible that such a case might arise where a borrower faces short-term liquidity constraints as a result of the COVID-19 pandemic and the lender has reasonable and supportable information that the borrower will receive assistance from the government or another third party that will resolve these constraints and there are no other indications of significant increase in credit risk in respect of the individual borrower.
- A key issue will be distinguishing between cases where the payment holiday provides relief from short-term liquidity constraints impacting the borrower that do not amount to a SICR considering the entire life of the instrument as against cases where there is a significant increase in the risk of default over the entire remaining life of the instrument (for example, because of longer-term liquidity or solvency problems). This is an extremely challenging distinction to make and will generally be dependent on the lender’s broader views on the macroeconomic impact of COVID-19 - e.g. how deep and long the macroeconomic problems will be, when and how quickly there may be a return to longer-term “normal” economic trends and the nature, extent and duration of direct government support to borrowers. It is important that the SICR assessment takes into consideration forward looking macro factors.
- The rebuttable presumption assumption that a SICR has arisen when contractual payments are more than 30 days past due is likely to be rebutted for clients benefitting from exceptional payment deferrals due to the crisis. For these clients, days past due (“DPD”) should no longer be used as a relevant automatic indicator of SICR. In light of these repayment arrangements and of the government support scheme, the existing mechanisms in place within banks and finance companies to trigger SICR may not be appropriate to address the exceptional circumstances of this crisis. These mechanisms would most likely fail to recognize the scale of various support measures being put in place by government authorities and central banks, both globally and in the UAE. Banking systems may not be configured to accommodate such a freezing in DPD and may result in changes in banking systems which could be challenging. However, consideration should be given as to when the 30 DPD count starts again as this may only be relevant for the period of the payment holiday.

Model overlays/ Post model adjustments

Extreme economic conditions - coupled with uncertainty around the duration of the pandemic, potential for relapses, effects of government support and what recovery will ultimately look like - mean that forward-looking judgements are highly uncertain and challenging to make. At the same time, historical relationships between key variables might no longer hold, and comparable economic conditions might not have existed in the past. Lockdown and social distancing effects and timeframes will need to be expressed in terms of impact on macroeconomic drivers and, ultimately, on default rates. It will not likely be possible to revise models in the short term to capture all of these factors and uncertainties. Banks often use overlays, or post-model adjustments, where risks and uncertainties cannot be adequately reflected in existing models. We expect that such overlays will necessarily play an even more important role and will be higher-level in today's environment.

Macro-economic scenarios

Banks shall immediately assess the impact of various economic scenarios by using their own models and by applying their own IFRS 9 accounting framework to update forecasts.

Changes in economic conditions should be reflected in macroeconomic scenarios applied by entities and in their weightings. If the effects of COVID-19 cannot be reflected in models, post-model overlays or adjustments will need to be considered. The environment is subject to rapid change and updated facts and circumstances should continue to be monitored as new information becomes available. Management should as a minimum consider reweighting the multiple scenarios to more accurately reflect the changes. Consideration if additional downside scenarios should be considered.

There is little doubt that economic conditions have deteriorated, and this should be reflected in the macroeconomic scenarios applied by an institution and their weightings. In some cases, the prior period downside scenario may be an appropriate starting point for the current base case. Estimates are likely to be refined as additional information becomes available that is relevant to assessing conditions at the reporting date.

Exposure at default ("EAD")

Exceptional drawdowns permitted and expected under TESS and any expected drawings on revolving facilities should be considered. Change in repayment behavior for overdrafts, probabilities of guarantee drawdowns (e.g. performance bonds) should be taken into account when assessing the EAD. If existing models are not able to capture the concerns above related to EAD, overlays/add-ons could be used instead of recalibration of models. However, there should be governance in place of how these add-ons have been determined.

Loss given default ("LGD")

- Collateral values need to be revisited considering recent market conditions.
- Additional downside scenarios need to be considered in the LGD computation in light of the current circumstances and appropriate weightings should be applied.

3.2. Loans and other debt funding from governments

- A bank receiving government funding in the form of a liability will need to analyse the relevant terms and conditions to conclude on the appropriate accounting and disclosure, including whether government grant accounting under IAS 20 is applicable.
- In particular, the bank will need to compare the interest rate payable on the loan with market pricing for other similar new borrowings at inception to determine whether the rate approximates market terms or is significantly off-market. Similar borrowings would be those with similar maturity, collateral and seniority/ subordination.

3.3. Classification of financial assets - practical issues

Equity instruments- An entity may elect to present in other comprehensive income ("OCI") changes in the fair value of an investment in an equity instrument if it is not held for trading. This option is available only on initial recognition and is irrevocable.

Debt instruments - Cash flows may be realised in a way that is different from expectations at the date on which the entity assessed the business model - e.g. if more or fewer financial assets are sold than was expected when the assets were classified. As long as the entity considered all relevant and objective information that was available when it made the business model assessment, this situation does not:

- Give rise to a prior-period error in the entity's financial statements; or
- Change the classification of the remaining financial assets held in that business model - i.e. those assets that the entity recognised in prior periods and still holds.

A change in the objective of an entity's business model will occur only when an entity either begins or ceases to carry out an activity that is significant to its operations - e.g. when the entity has acquired, disposed of or terminated a business line.

Therefore, under IFRS 9, the combination of events caused by the coronavirus pandemic and the related containment measures does not constitute, per se, a trigger for reclassification of financial assets.

3.4. Restructuring of financial assets

Another key issues will be to consider the accounting consequences associated with such payment deferrals.

A large number of clients are expected to be offered payment deferrals by which they will temporarily cease payments of principal and/or interest/profit. Their facilities may be re-scheduled or restructured, and in some cases, additional credit lines may be offered. The TESS scheme issued by the CBUAE intends to facilitate this process by offering zero-cost funding to banks and finance companies. Regulators recognise that some clients will also benefit from payment deferrals outside of the TESS scheme, as banks and finance companies may voluntarily offer payment deferrals to clients outside of this programme.

Banks will need to evaluate whether the modification results in the de-recognition of financial asset or not.

IFRS 9 does not provide guidance on when a modification of a financial asset should be considered substantial. Therefore, the assessment of whether a modification is substantial will depend on the lender's developed accounting policies and may require the exercise of judgement.

When the lender provides temporary payment relief and the net economic value of the loan is not significantly affected the modification would be unlikely to be considered substantial. The lender is required to recalculate the gross carrying amount of the financial asset by discounting the modified contractual cash flows at the original effective interest rate. The change in the gross carrying amount is recognised immediately in profit or loss.

4. Disclosures

For interim financial statements, IAS 34 Interim Financial Reporting requires in the interim financial report an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period (IAS 34.15, IAS 34.16A(d)).

For banks and finance companies, the decline in economic activity and resulting credit deterioration since the last reporting date would be such an event that would warrant disclosure. Consideration should be given to whether the IFRS 7 disclosures required in the annual financial statements should be partly reproduced in the interim financial report in order to comply with the explanation needed by IAS 34.

Banks and finance companies should reconsider the disclosure of judgements that management has made in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements (IAS 1.122). Management may have formed new judgements in light of the current economic environment that warrant disclosure that the previous financial statements did not. For example, an entity might have amended its definition of "significant increase in credit risk" or "credit-impaired".

Similarly, reconsideration of disclosure of sources of estimation uncertainty (IAS 1.125) will be needed given the uncertainties may have changed, or been exacerbated, since the last reporting period. ECL accounting often includes a significant degree of estimation uncertainty, but particularly so when the amount of uncertainty is higher given the various economic paths that could follow from the immediate outbreak of COVID-19. For example, an entity might have adjusted its approach regarding macro-economic forecasts and overlays. Banks and finance companies shall disclose changes to forward looking factors to ensure greater understandability of the financial statements and aid the users in assessing the impact of these macroeconomic variables on the financial statement.

Given the different impacts across sectors, updating previously disclosed analysis of portfolios by industry or region will be important. As was evident during the 2008 financial crisis, the level of granularity demanded by users will likely increase. For example, in the past a bank may have disclosed its exposure to the transport sector without further disaggregation. This may now need to be sub-analysed to help users understand the different underlying exposures and risks, for example by analysing the exposures into state backed airlines, shipping companies, private travel operators, and haulage and freight companies.

Entities should also refer to the guidance contained in IFRS 7.35J which requires appropriate disclosures to be made to enable users of financial statements to understand the nature and effect of modifications of contractual cash flows on financial assets that have not resulted in derecognition and the effect of such modifications on the measurement of expected credit losses.

Annual financial statements

For annual financial statements, IFRS 7 Financial Instruments: Disclosures requires extensive credit risk disclosures which shall enable users of financial statements to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows (IFRS 7.35B). Thus, the need to expand on qualitative disclosures will be critical in explaining how the current economic environment has impacted the amount, timing and uncertainty of future cash flows.

In particular, disclosures should help users understand the movement of exposures through the three stages of the general ECL model and the resulting impact on recorded amounts. In the current situation, particular consideration should be given to the disclosure requirements in IFRS 7 pertaining to how forward looking information is incorporated into the determination of ECL (IFRS 7.35G(b)), effect of modifications of contractual cash flows that have not resulted in derecognition (IFRS 7.35J) and the effect of collateral and other credit enhancements (IFRS 7.35L).

Furthermore, as noted for interim disclosures, due to the significant levels of estimates and judgements, disclosures in accordance with IAS 1.122 and IAS 1.125 would be very important. In particular, in preparing these disclosures, we would strongly recommend sensitivities be provided on the significant estimates.

Chapter II:

Industries Specific Guidelines

Section 16: Insurance Industry

Section 16: Insurance Industry

1. Introduction

The COVID-19 coronavirus pandemic is affecting insurance companies in many ways. In addition to customer, people and operational considerations, volatile markets have affected investment portfolios. Stock markets have declined in value, bond yields are at record lows and surging credit-default-swap indices are indicating concerns about increased defaults. This may impact insurers' balance sheets and capital ratios significantly.

The implications for insurance liabilities will be mixed depending on the specific types of coverage provided and the accounting policies applied under IFRS 4 Insurance Contracts. Insurers should assess the impact on liabilities for reported claims and incurred but not reported claims. They should also assess any knock-on effects for assumptions about reinsurance recoveries, future claims and disclosures. All businesses are trying to understand the full economic impact of the COVID-19 shutdown. We believe that this economic disruption has especially far-reaching impacts for the insurance industry.

The effect on insurance liabilities will vary by product type and coverage, with a general expectation that the frequency and/or severity of claims for most insurers will increase. In this paper, we look at:

1) Impact on insurance-related activities;

2) Disclosure and reporting considerations; and

3) Actions for management to take now.

2. Accounting considerations

Getting into more detail

IFRS 4 applies to insurance and reinsurance contracts and allows the continuation of pre-existing national accounting practices with few additional requirements – e.g. the liability adequacy test based on current estimates of all contractual cash flows. On the asset side of the balance sheet, many insurers continue to apply IAS 39 Financial Instruments: Recognition and Measurement although there are some who have early adopted IFRS 9. The insurers are allowed to continue with IAS 39 only in case they meet the criteria for overlay approach or temporary exemption requirements.

When assessing the impact on insurance liabilities, insurers should consider the coverage provided under the terms and conditions of issued insurance contracts. Stay-at-home regulations and resulting operational challenges may affect the claim settlement process and patterns. For example, claims payments may take more time and could result in a change in the paid-claim patterns used in some actuarial methods for calculating insurance liabilities. However, claims could be paid more quickly in the near term because insurers may face regulatory pressure to 'take care of the policyholder' during the pandemic; they may also forego regular claim adjudication procedures and question fewer claims before paying.

When determining their obligations, insurers need to evaluate the precise extent of coverage and the impact of exclusions and limitations on coverage. This includes an assessment of new directives, laws and regulations that may require insurers to provide coverage or incur claims for events related to COVID-19 in addition to those required by the existing terms and conditions in the insurance contract.

Further, when current demographic and market estimates (including discount rates) are reflected under existing accounting practices, an insurer should assess the extent to which the current developments around COVID-19 require a reassessment of those estimates. Consequently, an insurer may have to update the demographic and market assumptions used when measuring its insurance liabilities. Insurer should give consideration various impacts for e.g. to the impact of medical costs covered by government or Impact of mortality risk on future pricing and liability adequacy tests.

Regulation or contractual terms may provide for profit participation by policyholders. Insurers should therefore consider the impact on their obligations, including deferred bonuses.

A. Insurance reserves

The impacts to actuarially determined liabilities will vary based on the type of product and changes in policyholder behavior.

For insurers that sell term and traditional life products, because the active life reserves for such products use locked-in assumptions, discount rate, lapse rate and mortality table which are important factors. In prevailing low interest rate, discounting create significant PL impact, Lapse rate will goes up as people employment and source of income will get impacted and mortality table will get revised upward. Lower investment income resulting from a drop in interest rates and increased defaults and/ or increased death claims resulting from COVID-19 could cause these insurers to experience a loss recognition event that requires the unlocking of assumptions to current best estimates and writing down of deferred acquisition cost ("DAC") balances. If writing down the DAC balance does not result in a sufficiency, the insurer may need to further increase loss reserves. Further, reserving perspective insurers may want to move away from over prudence reserving approach to acceptable prudence which will requires deliberation on how this is treated whether change in accounting estimates or as a change in accounting policy.

For long- and short-duration health and disability products with outstanding liabilities ("OSL") and incurred but not reported reserves ("IBNR"), there could be increased volatility in claims emergence as policyholders take longer to submit claims and/or remain on disability or under medical treatment for longer periods. Historical trends are a key element in setting OSL and IBNR reserves and there could be significant breakage from these trends, given the unique nature of this outbreak. For example, waiving of deductibles and/or costs for COVID-19 care represent a departure from historical trends. Also, shelter- in-place regulations and resulting operational challenges may affect the claim settlement process and patterns. The elimination of cost sharing arrangements, such as coinsurance and co-pays for COVID-19 treatment will also disrupt established claim payment trends; however, those could be offset in the near term because of the reduction in elective medical treatment. In addition, since the reinsurer reinsurers may not agree with local mandate imposed on insurance companies to deal with COVID related claim if they are significantly different from their existing reinsurance terms, it may lead to the further impacting the accounting on reinsurer side.

To ensure OSL and IBNR represent current best estimates, insurers will evaluate assumptions such as separate account returns, investment earned rates, dynamic lapses, assessments, and claim lag time and make adjustments where indicated. Insurers also will need to evaluate the impact that a decrease in earned rates has on their loss recognition testing.

B. Deferred acquisition costs (“DAC”)

We may see shifts in sales by product type; for example, sales of fully underwritten products (which have higher issue costs and lower premiums) may slump while sales of higher premium policies that require minimal or no underwriting (e.g., life policies with no medical exam) may pick up. As sales shift, the processes used to allocate expenses to lines of business may need to be reviewed and updated.

For long-duration contracts with DAC amortized using either on straight line basis or any other systematic basis, insurers assess key assumptions related to amortization and evaluate changes from period to period and actual-to-expected results to determine if there is a potential for loss recognition. For example, key assumptions related to the use of current long-term interest rates may require reassessment.

C. Financial instruments

There are many potential GAAP accounting implications for financial instruments as a result of COVID-19. The more likely ones to have immediate impact on insurers include – those under IAS 39 considerations of credit losses on loans and receivables as well as available- for-sale (“AFS”) and held-to-maturity (“HTM”) debt securities. In addition, if an insurer has adopted the IFRS 9, expected credit loss model (“ECL”) will be different than the model used previously for these instruments and for reinsurance recoverables. Further guidance is available under IFRS 9 section.

In contrast, insurers not yet subject to IFRS 9 i.e. still applying IAS 39 will consider the extent to which COVID-19 has resulted in incurred credit losses, and the extent of those losses, arising from financial instruments such as receivables during the current period-end.

Insurers need to assess whether impairment losses should be recognised for investments that are not classified as at fair value through profit or loss. Under IAS 39, an investment is impaired if there is objective evidence. The disappearance of an active market because an entity’s financial instruments are no longer publicly traded is not evidence of impairment. A downgrade of an entity’s credit rating is not, of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information. A decline in the fair value of a financial asset below its cost or amortised cost is not necessarily evidence of impairment (for example, a decline in the fair value of an investment in a debt instrument that results from an increase in the risk-free interest rate). For available-for-sale equity investments, IAS 39 requires an impairment loss to be recognised if there has been a significant or prolonged decline in the fair value of the investment below its cost.

3. What are other disclosures and reporting considerations?

A. Litigation and loss contingencies

A spinoff of the claims handling process for business interruption and event cancellation insurance is an increase in lawsuits from policyholders alleging that insurers are failing to honor their obligations and wrongfully denying payouts because there was no property damage or loss during the outbreak. Insurers will want to monitor accounting implications from litigation and contingencies and ensure appropriate disclosures in the financial statements. Disclosures would include specificity regarding the nature of the matter; sufficient detail about new developments related to the litigation and loss contingencies and the effect of such developments on current and future periods; and sufficient detail about judgments and assumptions. Considerations would include the need to disclose amounts accrued, if any, and possible loss or range of loss or disclose why such an estimate cannot be made. The disclosures should align with publicly available information such as press releases, earnings calls, and counterparty filings. It is expected that disclosures about a contingency would be more robust as the likelihood and magnitude of loss increases and as the contingency progresses toward resolution.

B. Insurance liabilities and risks and uncertainties

Insurers may enhance disclosures as to the level of estimation uncertainty in response to challenges in estimating insurance liabilities given increased uncertainties related to claims development and key assumptions. Such uncertainties may also impact sensitivity analysis disclosures. Insurers will want to disclose the impact of COVID-19 risks on different types of business/products, how experience to date from the outbreak varies from existing assumptions, and how those risks are managed. Disclosures would also include considerations around risk concentrations, claims development tables, credit risks, market risks, and liquidity.

C. Others

Management shall:

I. Evaluate the specific implications for the company based on accounting policies applied and assess the impact on key assumptions for measuring insurance reserves, liabilities for reported claims, incurred but not reported claims, future claims, and reinsurance recoverable;

II. Consider implications related to quarterly reporting including evaluating your financial position at the reporting date; performing an accounting and disclosure impact assessment; and engaging with investors, regulators, policyholders, and other stakeholders to ensure clear communication;

III. Evaluate how to capitalize on strategic opportunities including consideration of the government stimulus opportunities, alternate policy offerings, pricing strategies, and potential emerging M&A opportunities;

IV. Consider performing updated stress testing to evaluate adequacy of insurance reserves as well as the company's overall financial position;

V. Consider whether economic uncertainties and market volatility have or will affect accounting conclusions, pricing decisions, disclosures, and other messaging to investors, analysts, regulators, and other stakeholders;

VI. Stay informed on developments in regulatory discussions and actions that may impact your company; and

VII. Consider the impact of the current situation on statutory capital and surplus as well as regulatory capital and action levels.

Chapter II:

Industries Specific Guidelines

Section 17: Retail Industry

Section 17: Retail Industry

1. Introduction

This section provides our insight into the top issues that entities in the retail industry might face. While this section focuses on issues that are likely to be the most frequently encountered, many others are certain to arise. As the situation continues to evolve, so too will the consequential accounting issues. For these reasons, the following is not an exhaustive list of all relevant accounting considerations.

The retail sector is facing a number of challenges related to the impact of COVID-19. While some big-box mass merchants and supermarkets are seeing spikes in traffic, other retailers have been experiencing declines in traffic as consumers adjust their shopping patterns. In addition, many retailers have temporarily closed stores, and more retailers may choose to close for the short term as the pandemic evolves. There has been a shift in sales from instore to online, which may increase shipping costs to the extent that they are not fully passed on to consumers.

Entities in the sector have also experienced disruptions in the supply chain, including those related to (1) competition for suppliers when acquiring raw materials, (2) decreased manufacturing capacity in certain locations, and (3) transportation patterns for merchandise. Many retailers are assessing the impact of production delays on inventory assortments and are considering options to mitigate the impact of such delays, including (1) a reassessment of the normal inventory logistics patterns and (2) increased use of air freight if available. As a result of concerns about the workforce (corporate and store employees alike), employees may work remotely or be furloughed. Further, certain retailers that had been facing operational challenges before the pandemic, or that have high leverage ratios, could experience liquidity challenges if they are unable to adequately manage inventory, payroll, and rent during any prolonged period of revenue decline.

The following are the key accounting considerations arising from the COVID-19 pandemic and affecting the retail companies in the UAE.

- Impairment of long-lived assets (e.g., store assets, ROU assets, goodwill and other intangibles);
- Lease modifications;
- Valuation of inventories;
- Revenue recognition;
- Liquidity considerations;
- Expected credit losses on trade receivables;
- Impact on employee compensation plans;
- Key judgements and accounting estimates;
- Restructuring plans;
- Subsequent events; and
- Going concern.

2. Impairment of long-lived assets (e.g., store assets, ROU assets, goodwill and other intangibles)

Reduced economic activity and lower revenues are likely to affect almost all entities in the UAE including retail entities which may indicate impairment.

Management should consider various issues, including whether:

- COVID-19 and the measures taken to control it are likely to reduce future cash inflows, or increase operating and other costs, for the reasons described above;
- The assumptions and cash flow forecasts used to test for impairment should be updated to reflect the potential impact of COVID-19;
- 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; and
- The approach to determining discount rates might need to be revisited.

Sometimes, an entity may conclude that the affected tangible fixed assets will be sold, abandoned, or otherwise disposed of. Under IFRS 5 Non-current Assets Held for Sale and Discontinued Operations, if the held-for-sale criteria are met, the entity is required measure the assets held for sale at the lower of its carrying amount and fair value less costs to sell.

Further as a result of the COVID-19 pandemic, retail entities are experiencing significantly reduced consumer traffic in retail stores and shopping areas, or indefinite closures due to quarantine measures and other government directives. Impairments to right-of use ("ROU") assets could occur as a result of business closures, supply chain disruption, or other consequences of the pandemic that negatively affect the future cash flows expected to be derived from the use of the underlying asset. In identifying whether the ROU asset is impaired, entities need to consider the fair value of the ROU asset less cost of disposal or the value in use. This includes estimating future cash flows, discount rates and other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset. In addition to the above, it should be noted that additional disclosures are likely to be required to enable users of the financial statements to understand the assumptions used and the sensitivity of the calculation to reasonable changes in those assumptions.

More detailed information and consideration is included under Section 5 - Impairment of Non-Financial assets in the document.

3. Lease modifications

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

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

When there is a change in lease payments, the accounting consequences will depend on whether that change meets the definition of a lease modification, which IFRS 16 Leases defines as "a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease (for example, adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term)".

IASB finalised amendment to IFRS 16 regarding COVID-19-related rent concessions which are effective for annual reporting periods beginning on or after 1 June 2020. Earlier application is permitted, including in financial statements not yet authorised for issue at 28 May 2020. The amendment is also available for interim reports.

More detailed information and consideration is included under Section 10 - Leases in the document.

4. Valuation of inventories

The COVID-19 pandemic may affect the recoverability of inventory balances. Some entities with inventories that are seasonal or are subject to expiration may have to assess whether a write-down for obsolescence or slow-moving stock may be necessary at each reporting date as a result of a slower sales pace. Other entities may have to assess whether a decline in their future estimated selling price is expected, which may indicate a potential write down in the cost of inventory may be required at the reporting date.

As per IAS 2 Inventories, inventories are measured at the lower of their cost and net realisable value ("NRV"). As a result of the pandemic, NRV of an item of inventory may fall below its cost for many reasons, including a decline in selling prices (e.g. as a result of price concessions offered to customers), or an increase in the estimate of costs to complete and market the inventories (e.g. increased costs to provide protection to employees).

More detailed information and considerations are included in Section 6 - Provisions and contingencies in the document.

5. Revenue recognition

Business disruptions associated with the COVID-19 pandemic may prevent an entity from entering into customer agreements by using its normal business practices, which may make the determination of whether it has enforceable rights and obligations challenging. To help its customers or to provide incentives for them to continue purchasing its goods or services, an entity may (1) revise its agreements to reduce any purchase commitments; (2) allow customers to terminate agreements without penalty; or (3) provide price concessions, discounts on the purchase of future goods or services, free goods or services, extended payment terms or extensions of loyalty programmes.

Further, because the entity itself may be experiencing financial difficulties and supply disruptions, it may (1) request up-front payments from its customers; (2) delay the delivery of goods or services; (3) pay penalties or refunds for failing to perform, not meeting service-level agreements, or terminating agreements; or (4) incur unexpected costs to fulfil its performance obligations. Therefore, as a result of the changes in circumstances experienced by both an entity and its customers due to the COVID-19 pandemic, an entity may need to consider the following when assessing revenue from contracts with customers:

- Contract enforceability: In certain circumstances, the parties may not be able to approve a contract under an entity's normal and customary business practices. For example, the entity may not be able to obtain the signatures it normally obtains when entering into a contract because personnel from the entity or customer are unavailable or otherwise unable to provide signatures. Therefore, it is important to carefully evaluate whether the approval process creates a contract with enforceable rights and obligations between the entity and its customer. In making this determination, an entity may consider consulting with its legal counsel. If enforceable rights and obligations do not exist, revenue cannot be recognised until certain conditions are met. The effect of a "force majeure" clause allowing the parties to terminate a contract without incurring penalties in certain extraordinary circumstances will also need to be considered.
- Collectability: An entity should not reassess whether a contract meets the criteria in IFRS 15:9 after contract inception unless there has been a significant change in facts and circumstances. If the impacts of the COVID-19 pandemic result in a significant deterioration of a customer's or a portfolio of customers' ability to pay, the entity should reassess collectability. In case the reassessment results in the collectability criterion not being met, the entity is precluded from recognising further revenue under the contract until collectability becomes probable. Because of the significant uncertainty associated with the effects of the pandemic, it is important for the entity to document the judgements it made and the data or factors it considered.
- Contract modification: An entity may modify its enforceable rights or obligations under a contract with a customer. For example, the entity may grant a price concession to a customer. In that circumstance, the entity should consider whether the concession is due to the resolution of variability that existed at contract inception (i.e. a change in transaction price associated with variable consideration) or a modification that changes the parties' rights and obligations. A price concession that is provided solely as a result of the COVID-19 pandemic most likely represents a modification that changes the parties' rights and obligations. Conversely, a price concession that had always been envisaged as possible and was therefore already being treated as variable consideration continue to be accounted as such even though it may be triggered by COVID-19. An entity should consider if there have been modifications to contractual terms as a result of the COVID-19 situation? When were these modifications agreed with the customer (pre- or post-balance sheet date) and how should they be accounted for? Typically, modifications should not be accounted for until they are approved by both parties.
- Variable consideration: The entity may need to consider any expected changes in (1) its ability to perform; and (2) customer behaviour that results from deteriorating economic conditions. For example, an entity may need to consider updating its estimated transaction price if it expects an increase in product returns, customer loyalty schemes, decreased usage of its goods or services or decreased royalties, increased invocation of retrospective price protection clauses, changes in redemption rates of coupons or volume rebates, or to potentially pay contractual penalties or liquidating damages associated with its inability to perform (e.g. the inability to deliver goods or services on a timely basis or to meet service-level agreements). In certain circumstances, an entity's estimate of penalties or liquidated damages could be limited by force majeure clauses. Further, an entity may need to reconsider whether it will be able to achieve milestone payments, performance bonuses, trailing commissions based on renewals, or other performance-related fees. If there is a reduction in the estimated transaction price, a change in estimate may result in the reversal of revenue for amounts previously recognised as variable consideration (e.g. as a result of an increase in return reserves).
- Material right: To mitigate any decline in sales, an entity may offer its customers sales incentives, including discounts on future goods or services. In this circumstance, the entity should evaluate whether a sales incentive on the purchase of future goods or services represents (1) a material right in accordance with IFRS 15:B40 that is associated with a current revenue contract (whether explicit or implicit because there is a reasonable expectation on the part of a customer that he or she will receive a sales incentive at contract inception); or (2) a discount that is recognised in the future upon redemption (i.e. when revenue is recognised for the related goods or services) in a manner consistent with IFRS 15:72. In addition, for new or modified contracts, an entity may need to update its estimates of the stand-alone selling price of a material right (e.g. because the entity extended the periods for use or provided additional incentives to a customer) or to reassess its breakage assumptions (e.g. because of extensions or changes in expected usage patterns).

For example, an entity may modify its loyalty programme by extending customers' ability to use points; this change may require the entity to reassess the breakage assumptions it uses.

- Implied performance obligations: An entity may assist its customers by providing them with free goods or services that are not explicitly promised in the contract. In a manner consistent with IFRS 15:24, an entity should determine whether its contracts with customers contain promised goods or services that are implied by its customary business practices or published policies or by specific statements that create a reasonable expectation of the customer that the entity will transfer those goods or services. There may also be instances in which an entity provides free goods or services to its customer that are not part of a prior contract with that customer (i.e. when the prior contract was entered into, there were no explicit or implicit obligations to provide those goods or services). An entity must carefully evaluate whether the additional promised goods or services are a modification of a pre-existing customer contract or a cost incurred that is separate from any pre-existing contracts. In many cases, free goods or services provided to a customer solely as a result of the COVID-19 pandemic (that are not part of another newly entered contract with that customer) will not be considered a contract modification, in particular if they are broad-based and not negotiated with the customer (e.g. an internet service provider increasing monthly data allowances without additional charge for all customers for a three-month period to support working from home and home schooling activities). However, an entity may need to determine whether it has developed a practice that creates an implied promise in future contracts.

- Recognition of revenue: Because of potential supply disruptions or other circumstances, an entity may need to reconsider the timing of revenue recognition if it is unable to satisfy its performance obligations on a timely basis. Revenue cannot be recognised until control of the goods or services transfers to the customer (i.e. when the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the goods or services). Sometimes, delays in the transfer of goods or services may be caused by the customer or other external factors. For example, a customer may not be able to obtain physical possession of a product because of shipping delays or because it cannot receive the product (e.g. warehouse personnel may be unavailable). In such cases, an entity should carefully consider when control of the product transfers (e.g. before or after shipment). Further, if a customer is unable to take physical possession of the product, it may request that the entity retain the product on a bill-and-hold basis. In this circumstance, the entity would need to consider the bill-and-hold guidance in IFRS. An entity may also incur unexpected costs in fulfilling a performance obligation that is satisfied over time. If the entity is using costs incurred to date as an input method to measure progress towards complete satisfaction of its performance obligation, it should be careful to ensure that revenue attributed to work carried out is not increased to offset additional costs incurred when abnormal or excessive costs arise as a result of inefficiency or error.

- Disclosure requirements: Many of the circumstances described above could affect an entity's disclosures. Therefore, it is important for the entity to disclose any significant judgements and estimates it makes in accounting for its revenue contracts (e.g. assessing collectability; estimating and constraining variable consideration; measuring obligations for returns, refunds, and other similar obligations; measuring progress toward completion of a performance obligation recognised over time; and determining the standalone selling prices and breakage assumptions for material rights).

More detailed information and considerations are included in Section 8 - Revenue Recognition (IFRS 15) in the document.

6. Liquidity considerations

Working capital is likely to be significantly impacted - long lead times on non-food products coupled with declining demand may stretch the working capital of many retailers. Additionally, working capital is heavily impacted from delay in customer payments because many of its customers are experiencing financial difficulties and liquidity issues. Thus an entity may need to develop additional procedures to properly assess the collectability of its customer arrangements. The latest measures taken by authorities will have significant impacts on retailers and give rise to the risk of liquidity issues.

Entities will need to consider whether such disruption will be prolonged and result in diminished demand for products or services or significant liquidity shortfalls (or both) that, among other things, cause management to assess whether the entity may be able to continue as a going concern for at least, but not limited to, 12 months from the reporting date and could also be impacted on:

- Financing arrangements;
- Ability to raise new/ refinance;
- Debt covenants; and
- Liquidity risk disclosures.

The impacts on these items will need to be carefully monitored. Refer to Section 1 - Financial Stability and Going Concern in the document.

7. Expected credit losses on financial assets

IFRS 9 requires entities to use an expected credit loss ("ECL") model to measure impairment of most financial assets.

The model requires consideration of both historical and current information, as well as reasonable and supportable forecasts of future conditions (including macroeconomic information). Many companies in the industry use the simplified model for trade receivables and they measure the ECL at the lifetime expected credit losses.

Refer to Section 2 - Impairment of Financial Assets in the document

8. Impact on employee compensation plans

There might be an impact on holiday pay accruals if large portions of the workforce defer holiday or on significant staff sickness in this period. Management should also consider whether any of the assumptions used to measure the employee benefits have been impacted by the current global economic situation such as discount rate, salary continuation, salary increase, etc.

9. Key judgements and accounting estimates

When considering the impact on accounting estimates, specific challenge needs to be given to the sensitivities applied by management to forecast trading performance. There is a significant impact on retailers due to new guidance issued on social distancing, including the recommendation to avoid public places, to work from home where possible, to minimise social contact and self-isolation for 'at risk' people including the elderly by relevant authorities. Client sensitivities should consider these risks and the impact they would have on performance and liquidity.

Refer Section 11 - Changes in Estimates (Changes in Significant Accounting Estimates) of this document for details

10. Restructuring plans

Those companies with high debt-burdens pre-crisis will find this a difficult storm to weather. Even those with stronger cash positions will face profitability challenges with decreased demand and high levels of unsold-inventory. While some retailers may shudder, this reshuffling will provide opportunities for innovation, strategic partnerships and acquisitions.

The COVID-19 coronavirus outbreak has impacted many companies adversely - e.g. affecting their production processes, disrupting their supply chains, causing labour shortages and leading to closures of stores and facilities.

Management may consider downsizing or discontinuing specific operations; conversely, some companies may plan to explore a new business opportunity. All of these may lead to a restructuring.

Refer Section 6 - Provisions and Contingencies of this document

11. Subsequent events

Many governments have introduced various measures to combat the outbreak, including travel restrictions, quarantines, closure of business and other venues and lockdown of certain area. These measures have affected the global supply chain as well as demand for goods and services. Management need to continue to consider the impact of COVID-19 that existed at the reporting date and should be incorporated into the measurement of assets and liabilities at the reporting date. Additionally, needs to consider appropriate disclosures for the nature and impact of COVID-19 for non-adjusting events in particular.

Refer Section 12 - Subsequent Events of this document

12. Going concern

Given the current uncertainty and the variety of outcomes still possible related to the course of the pandemic and its adverse impact on economies all over the world, entities will need to consider a wide range of factors related to current and expected profitability, among other things. There may be cases when an entity concludes, after having considered all relevant information, including the feasibility and effectiveness of planned mitigation, that there are no material uncertainties that cast substantial doubt about its ability to continue as a going concern requiring disclosure under IAS 1:25.

In making this assessment, management will need to take into account all information available up to the date of authorisation of the financial statements (in certain jurisdictions, local regulations may extend this period). The information to be considered includes government announcements affecting the ability of an entity to operate and of any government assistance programmes to which the entity may be entitled. When management is aware of material uncertainties that cast a significant doubt on the entity's ability to continue as a going concern, IAS 1:25 requires the entity to disclose those material uncertainties in the financial statements. The disclosure should be specific to the entity's own situation, for example explaining how and when the uncertainty may crystallise and its impact on the entity's resources, operations, liquidity and solvency.

Refer Section 1 - Financial Sustainability and Going Concern of this document

Chapter II:

Industries Specific Guidelines

Section 18: Construction Industry

Section 18: Construction Industry

1. Introduction

This section provides our insight into the top issues that entities in the construction industry might face. While this section focuses on issues that are likely to be the most frequently encountered, many others are certain to arise. As the situation continues to evolve, so too will the consequential accounting issues. For these reasons, the following is not an exhaustive list of all relevant accounting considerations.

The following are the key areas that should be considered for companies in the UAE:

- Revenue;
- Impairment considerations for goodwill, tangible fixed assets and investments in associates and joint ventures;
- Liquidity considerations;
- Expected credit losses on contract assets;
- Impact on employee compensation plans; and
- Borrowing costs for point in time recognition.

2. Revenue

As many construction entities in the UAE recognise their revenue over time in accordance with paragraph 35 of IFRS 15. Management will need to consider the assumptions that underpin their revenue accounting in addition issues would need to be considered:

- Status of projects at the reporting period and subsequently. Are the projects continuing as normal in the current environment or have they been delayed, suspended or postponed? Are there force majeure clauses in contracts which have been triggered by COVID-19-related events? Are projects now operating at lower efficiency levels than previously, and how will this impact the overall outturn of the project?
- Measurement of progress through a contract. For example:
    - o If a ‘cost to cost’ method is used to measure progress and to determine how much revenue to recognise in the period, should expected cost increases resulting from delays, suspensions or postponements be built into the denominator of the ‘cost to cost’ calculation, or are they abnormal costs/inefficiencies that should be excluded? What would be a reasonable estimation process to determine the potential impact on costs?

- o To what extent should any claims against the company from suppliers, or claims made by the company against their suppliers, be taken into account when considering cost forecasts and the overall outturn of projects?

- Contract modifications. Have there been modifications to contractual terms as a result of the COVID-19 situation? When were these modifications agreed with the customer (pre- or post-balance sheet date) and how should they be accounted for? Typically, modifications should not be accounted for until they are approved by both parties.
- For variations and claims with customers, the question arises to what extent any additional revenue can be taken into account due to delays, postponements or changes in scope? Entities should consider to what extent variations are enforceable under contractual terms that existed at the balance sheet date.
- Liquidated damages (or other penalties to the customer for delayed completion of projects) or other forms of variable consideration. Do assumptions about variable consideration (such as liquidated damages, milestones or other bonuses/penalties) need to be updated in revenue calculations?
- Given changes in expected outturn of projects, might there be onerous contract provisions required, including projects delivered in collaboration with other parties?
- For entities recognising revenue over time in accordance with paragraph 35(c) of IFRS 15, would the right to payment for performance to date continue to be enforceable in the current environment?
- How do contractual terms, legislation and government actions differ from jurisdiction to jurisdiction, and might this drive different accounting outcomes in different territories?

For further consideration, refer to Revenue section 8 and Provisions section 6 of the main document.

3. Impairment considerations for goodwill, tangible fixed assets and investments in associates and joint ventures

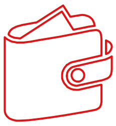
Reduced economic activity and lower revenues are likely to affect almost all entities in the UAE including construction entities which may indicate impairment. Certain construction contracts may be delayed or postponed.

Management should consider various issues, including whether:

- COVID-19 and the measures taken to control it are likely to reduce future cash inflows, or increase operating and other costs, for the reasons described above;
- The assumptions and cash flow forecasts used to test for impairment should be updated to reflect the potential impact of COVID-19;
- 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; and
- The approach for determining discount rates might need to be revisited.

In addition to the above, it should be noted that additional disclosures are likely to be required to enable users of the financial statements to understand the assumptions used and the sensitivity of the calculation to reasonable changes in those assumptions.

More detailed information and consideration is included under Section 5 - Impairment of Non-Financial assets in the document.



4. Liquidity considerations

Decreases in pricing or volumes, due to issues such as price concessions, supply chain failures and work stoppages, could lead to potentially significant declines in cash flows, and they could therefore impact:

- The going concern assumption;
- Liquidity risk disclosures; and
- Debt covenants.

The impacts on these items will need to be carefully monitored.

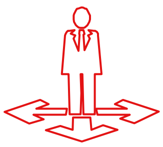
Refer to Section 1- Financial Stability and Going Concern in the document.

5. Expected credit losses on contract assets

IFRS 9 requires entities to use an expected credit loss (“ECL”) model to measure impairment of most financial assets.

The model requires consideration of both historical and current information, as well as reasonable and supportable forecasts of future conditions (including macroeconomic information). Contract assets are within the scope of the ECL model. Many companies in the industry use the simplified model for trade receivables and contract assets, and they measure the ECL at the lifetime expected credit losses.

Refer to Section 2 - Impairment of Financial Assets in the document.



6. Impact on employee compensation plans

Construction entities typically have a large workforce and significant end of service benefit obligations. There might be an impact on holiday pay accruals if large portions of the workforce defer holiday in this period. Management should also consider whether any of the assumptions used to measure the employee benefits have been impacted by the current global economic situation.

For example, one of the inputs into the measurement of the defined benefit obligation is the yield on either high-quality corporate bonds or government bonds; this might have changed as a result of the current situation.

7. Borrowing costs for point in time recognition

Borrowing costs that are attributable to the acquisition, construction or production of a qualifying asset are capitalised as part of the cost of that asset. [IAS 23 para 8]. An entity should suspend capitalisation of borrowing costs during extended periods in which it suspends active development of a qualifying asset. [IAS 23 para 20]. IAS 23 does not provide guidance regarding what it envisages to be an 'extended period'. Where construction activities are interrupted, but the cessation is a necessary and foreseeable part of the process, capitalisation of borrowing costs can continue, as set out in paragraph 21 of IAS 23.

The COVID-19 conditions and associated lockdowns and/or restrictions are not considered to be a necessary part of the process of getting an asset ready for its intended use or sale. Nor is the COVID-19-related cessation of activities considered necessary during the construction period of an asset. However, the term 'activities' does encompass more than physical construction of the asset. Where substantial technical and administrative work is carried out, capitalisation of borrowing costs should continue, even if physical construction has ceased. [IAS 23 para 21].

The assessment of whether or not the lockdowns and/or restrictions result in an extended period in which active development on a qualifying asset has ceased is a matter of judgement. The following factors might be taken into account when making the judgement (not an exhaustive list):

- Although the lockdown or restrictions might be the initial reason why the activities have ceased, management might take into account updated budgets and revised business plans which might cause the activities to be delayed for longer than just the lockdown period.

- The total period of suspension, not only the period of government-imposed lockdown or restrictions, will need to be considered. Further to this, if a reporting date falls within a period in which activities have ceased, management might need to estimate when activities are likely to resume again, which might only be during the next reporting period. The period from the start of the suspension to the estimate of when the activities are expected to resume will need to be considered. Caution should be exercised in forecasting the projected length of delay.

  Management should consider the requirements of IAS 10, 'Events after the reporting period', and, in particular, whether the latest developments provide more information about the circumstances that existed at the reporting date.

- The nature of the activities that are still being performed during the lockdown and/or restrictions - that is, if substantial technical and administrative work continues during the lockdown and/or restrictions, borrowing costs would likely continue to be capitalised, even though physical construction might have been suspended. [IAS 23 para 21].

- The projected length of the delay relative to the time period ordinarily expected for the construction of the specific asset. The shorter the projected length of delay relative to the project as whole, the more likely it is that borrowing costs should continue to be capitalised.

- The possibility of the lockdown and/or restriction period being extended or the implementation of a phased approach that might allow some construction to be performed. A phased approach to lifting the lockdown and/or restrictions might mean that activities to prepare the asset could resume sooner than waiting for the lockdown and/or restrictions to be lifted in their entirety.

Chapter II:

Industries Specific Guidelines

Section 19: Real Estate Industry

Section 19: Real Estate Industry

1. Introduction

This section provides a summary of accounting issues that real estate entities might face. This guidance may focus on issues that are likely to be the most frequently encountered, many others are certain to arise. As the situation continues to evolve, so too will the consequential accounting issues. For these reasons, the following is not an exhaustive list of all relevant accounting considerations.

The following are the key areas that should be considered:

- Valuation of investment property;
- Impairment of investment property using cost method;
- Operating lease accounting implications for lessors; and
- Revenue recognition for developers.

2. Valuation of investment property

COVID-19 has given rise to many significant uncertainties and these uncertainties have affected the valuation of investment property particularly given the impact on lessors. The carrying value of investment property held at fair value is often determined by way of engaging an external valuer. In the context of COVID-19, valuation reports received from external valuers may contain an uncertainty or qualifying clause in relation to certain aspects of the valuation. For example, the uncertainty may relate to the lack of empirical data upon which to determine a quantitative estimate for a key input such as cash flow assumptions.

Nonetheless, IFRS 13 requires an entity to develop unobservable (Level 3) inputs using the best information available in the circumstances, which might include an entity's own data. This data should be adjusted if reasonably available information indicates that other market participants would use different data. However, an entity need not undertake exhaustive efforts to obtain information about market participant assumptions. As such, a fair value needs to be determined and it cannot purport to use the previous value or cost.

It might not be possible for companies to factor all of these uncertainties into a single set of cash flow forecasts. Rather, there might be a range of potential outcomes that need to be included as different scenarios with appropriate weightings applied to each. Management would need to document its basis for the factors that have been built into each scenario, including the probability weights applied to each of the scenarios.

In most valuations, entities in practice use an expected cash flow model. Even if management is not explicitly modeling scenarios, it is implicitly probability weighting the possible scenarios to arrive at a single forecast. Another approach is to use a forecast that is not an expected cash flow forecast, for example, management's best estimate. IFRS 13 requires the use of a discount rate that is consistent with the risk inherent in the cash flows. This means that the discount rate applied to the expected cash flows and "best estimate" cash flows are not the same. If the cash flow forecasts do not fully reflect multiple scenarios capturing the range of relevant outcomes, an entity may need to add a company-specific risk premium, also known as an alpha, to the discount rate. This will result in a higher discount rate that reflects the risks in the forecast. More guidance on the interplay between the discount rate and cash flow forecast can be found in the International Valuation Standards issued by the International Valuation Standards Council (specifically in paragraph 50.38).

A multiple scenario approach may eliminate the need for the alpha since discount rates should not be adjusted for risks that are already reflected in the cash flows.

If management moves from a single set of cash flows to a probability weighted set of cash flows, this represents a change in accounting estimate in accordance with IAS 8, which should be accounted for as such. However, in accordance with IFRS 13 paragraph 66, the disclosures in IAS 8 for a change in accounting estimate are not required for revisions resulting from a change in a valuation technique or its application. IFRS 13 paragraph 65 cites changing market conditions is an example of a circumstance where a change in valuation technique or its application may be appropriate.

Additionally, IFRS 13 deals with uncertainty in relation to Level 3 fair value measurements through providing users with appropriate disclosure. For example, including a description of the valuation techniques used, how decisions are made in relation to valuation procedures and [for recurring fair value measurements] the sensitivity of fair value measurements to significant unobservable inputs".

More detailed information and consideration is included under Section 4 – Fair Value in the document.

3. Impairment of investment property using cost method

For detailed guidance related to impairment of investment property please refer to Section 5 – Impairment of Non-Financial Assets in the document.

4. Operating lease accounting implications for lessors

The following are common issues noted in real estate entities with respect to leases.

Lease concessions granted to tenants

As a result of the COVID-19 pandemic, landlords have granted rental concessions to a number of tenants. These concessions take a variety of forms, including payment holidays, cash rebates and deferral of lease payments. On 10 April 2020, the International Accounting Standards Board “IASB”) issued a document intended to support the consistent application of IFRS to lease concessions related to COVID-19. Whilst in May 2020, the IASB issued an amendment to IFRS 16 – Leases (“IFRS 16”) for rent concessions it is important to note this only applies to lessees and not lessors.

Payments due to a lessor under an operating lease agreement might be amended as a result of the COVID-19 pandemic. Judgement will be needed to determine the appropriate accounting treatment for lease concessions that are made in the context of COVID-19. Depending on the facts and circumstances, the substance of the concession might be appropriately accounted for as negative variable lease payments, forgiveness of some of the lease payments, deferral of some of the lease payments, or a lease modification. Accordingly, a lessor will need to consider all relevant facts and circumstances (including any pre-existing clauses in the lease contract and any relevant laws or regulation that apply to the lease contract) to determine the appropriate accounting treatment.

Where an operating lease is not modified, but some of the payments are no longer due under the lease agreement (for example, because of force majeure or similar clauses in the contract or applicable laws or regulation), it would be appropriate for the lessor to treat the change to the payments as a negative variable payment and to reduce the recognition of revenue for the periods affected by the amount that is no longer to be paid under the contract by the lessee.

On the other hand, where an operating lessor determines that the concession is appropriately accounted for as a lease modification, it would apply paragraph 87 of IFRS 16. That paragraph requires a modification to an operating lease to be accounted for "as a new lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease".

Note that, if non-lease components exist within a contract, modifications of non-lease components would be dealt with under the other relevant standard (for example, IFRS 15 - Revenue for non-lease services).

Below are some scenarios that may be noted for operating leases setting out the application of these principles to each scenario is as follows:

Scenario A: The operating lease lessor is required to reduce payments for a particular month because of force majeure clauses in the contract or applicable laws or regulation. These payments are no longer due by the lessee and the lease is not extended.

In this case, the lessor is required by contract or law/regulation to reduce payments. Accordingly, the reduced payments owing by the lessee might not be considered to result from a lease modification, since they are provided in accordance with existing contractual / legal terms. If the entity concludes that the concession is not a modification, it should apply the guidance for negative variable lease payments.

Scenario B: An operating lease lessor voluntarily grants a short-term payment deferral for fixed lease payments that would otherwise be due. There is no interest charged on the deferred payments, and the payments are due at the end of the current year.

The lessor might consider that the short-term deferral is proportionate, and so it does not change the consideration for the lease. Accordingly, the lessor does not view the change as a lease modification.

In this case, an operating lessor would account for the nominal payments due under a lease over the lease term on the same basis as before the change (which, for operating leases, is typically straight-line), without considering the impact of the time value of money on the related revenue.

Since the modification does not change the total consideration, the amount of revenue to be recognised in each period throughout the lease will not change.

However, to the extent that the deferrals result in a build-up of an accrued rent receivable or debtor relating to straight-line rent recognition, the lessor should apply the relevant impairment requirements under IFRS 9.

Scenario C: An operating lease lessor voluntarily forgives certain lease payments in advance of them being due.

The voluntary forgiveness of lease payments that are not yet due under an operating lease (and hence have not been recognised as a receivable) is a modification of the lease. Accordingly, paragraph 87 of IFRS 16 applies, such that the modified lease should be accounted for as if it was a new lease when the payments are forgiven.

The forgiveness will impact the total consideration to be received by the lessor over the term of the lease and, as a result, it will impact the amount of revenue that the lessor records on a straight-line basis over the lease term. The periods in which no payments are owing by the lessee would be similar to a rent-free period granted by the lessor, and similar accounting would result – that is, the lessor would remeasure the total rentals to be recognised based on the revised consideration for the remaining term, and continue to recognise this revised rental revenue on a straight-line basis in the periods forgiven based on this revised calculation.

Force majeure clauses

Some lease contracts contain force majeure clauses that apply in the case of serious unforeseen circumstances beyond the control of the parties to the contract. In addition, actions of governments taken in response to COVID-19 might be accounted for in a similar way to some force majeure clauses. The nature of such clauses can differ. The existence of force majeure clauses in leasing contracts might result in payments being accounted for as variable lease payments rather than as lease modifications, similar to what has been discussed above.

Impairment

For any financial instruments that are within the scope of IFRS 9's expected credit loss ("ECL") model, the impact of COVID-19 on the ECL should be considered. Lease receivables are within the scope of IFRS 9's ECL model. Such receivables include a lessor's accrued rent receivables on operating leases (including operating leases of investment properties). These accrued rent receivables might be recognised as a result of lease incentives such as rent-free periods or periods of reduced rental payments, as well as payments made by a lessor to a lessee – for example, an upfront payment in relation to fit-out costs, which is recognised as accrued rent receivable by the lessor and amortised over the lease term to the income statement.

Reassessment of lease term

In the current environment, retail tenants might need to reassess the lease term of their property leases. However, it also notes that a lessor does not reassess lease term after the commencement date of the lease, and so it would not assess whether or not an option is now reasonably certain to be exercised by the lessee.

Recognition of lease income

As a result of COVID-19, collectability of rentals on some operating leases has become increasingly uncertain. Paragraph 81 of IFRS 16 requires a lessor to recognise lease payments from operating leases as income on either a straight-line basis or another systematic basis. IFRS 16 does not specify a collectability criterion that must be met in order for a lessor to recognise operating lease income. A lessor could therefore continue to recognise operating lease income.

However, a lessor is required to apply IFRS 9's impairment requirements to lease receivables. Impairment losses on lease receivables should be recognised separately as an expense. However, alternatively an approach to only recognise what would be considered collectible would also be appropriate. Whatever approach is followed should be applied consistently.

5. Revenue recognition for developers

As many real estate entities in the UAE recognise their revenue over time in accordance with paragraph 35 of IFRS 15. Management will need to consider the assumptions that underpin their revenue accounting. Several issues would need to be considered:

- The impacts of COVID-19 outbreak may call into question the ability of companies, and their customers, to abide by the stated terms of their contracts. This may affect the timing and amount of revenue to be recognised – or whether revenue should be recognised at all.

For example, companies may need to consider the following.

- o Customers may now struggle to meet their contractual obligations. Does this mean that companies should stop recognising revenue for existing contracts and not recognise revenue for new contracts?
- o Rights to payment for performance to date may not be enforceable – e.g. due to force majeure or similar clauses being invoked. Does this affect whether revenue can be recognised over time?
- o Companies and their customers may seek to change the terms of existing contracts to respond to the impacts of the COVID-19 outbreak on their business. How should companies account for these contract modifications?
- o Determining whether rights and obligations are enforceable may require significant judgement and regular reassessment. As circumstances continue to change, companies should monitor the enforceability of their contract terms closely.
- o Status of projects at the year end and subsequently. Are the projects continuing as normal in the current environment or have they been delayed, suspended or postponed? Are there force majeure clauses in contracts which have been triggered by COVID-19-related events? Are projects now operating at lower efficiency levels than previously, and how will this impact the overall outturn of the project?

- Measurement of progress through a contract. For example:
  - o If a 'cost to cost' method is used to measure progress and to determine how much revenue to recognise in the period, should expected cost increases resulting from delays, suspensions or postponements be built into the denominator of the 'cost to cost' calculation, or are they abnormal costs/inefficiencies that should be excluded? What would be a reasonable estimation process to determine the potential impact on costs?
  - o To what extent should any claims against the company from suppliers, or claims made by the company against their suppliers, be taken into account when considering cost forecasts and the overall outturn of projects?

- ▪ Given changes in expected outturn of projects, might there be onerous contract provisions required, including projects delivered in collaboration with other parties?
- ▪ How do contractual terms, legislation and government actions differ from jurisdiction to jurisdiction, and might this drive different accounting outcomes in different territories.

Chapter II:

Industries Specific Guidelines

Section 20: Manufacturing Industry

Section 20: Manufacturing Industry

1. Introduction

This section provides our insight into the top issues that entities in the manufacturing industry might face. While this section focuses on issues that are likely to be the most frequently encountered, many others are certain to arise. As the situation continues to evolve, so too will the consequential accounting issues. For these reasons, the following is not an exhaustive list of all relevant accounting considerations.

The following are the key accounting considerations arising from the COVID-19 pandemic and affecting the manufacturing companies in the UAE:

- Revenue recognition;
- Valuation of inventories;
- Impairment considerations for goodwill, tangible fixed assets and investments in associates and joint ventures;
- Liquidity considerations;
- Expected credit losses on trade receivables; and
- Impact on employee compensation plans.

2. Revenue recognition

Business disruptions associated with the COVID-19 pandemic may prevent an entity from entering into customer agreements by using its normal business practices, which may make the determination of whether it has enforceable rights and obligations challenging. In addition, because many of its customers are experiencing financial difficulties and liquidity issues, an entity may need to develop additional procedures to properly assess the collectability of its customer arrangements and consider changes in estimates related to variable consideration (e.g. because of greater returns, reduced usage of its products, or decreased royalties). To help its customers or to provide incentives for them to continue purchasing its goods, an entity may (1) revise its agreements to reduce any purchase commitments; (2) allow customers to terminate agreements without penalty; or (3) provide price concessions, discounts on the purchase of future goods or services, free goods or services, extended payment terms or extensions of loyalty programmes. Considering these, management will need to reconsider the assumptions that underpin their revenue recognition. Several issues would need to be considered including the following:

- **Contract enforceability:** In certain circumstances, the parties may not be able to approve a contract under an entity's normal and customary business practices. For example, the entity may not be able to obtain the signatures it normally obtains when entering into a contract because personnel from the entity or customer are unavailable or otherwise unable to provide signatures. Therefore, it is important to carefully evaluate whether the approval process creates a contract with enforceable rights and obligations between the entity and its customer. In making this determination, an entity may consider consulting with its legal counsel. If enforceable rights and obligations do not exist, revenue cannot be recognised until certain conditions are met. The effect of a "force majeure" clause allowing the parties to terminate a contract without incurring penalties in certain extraordinary circumstances will also need to be considered.

- **Collectability:** An entity should not reassess whether a contract meets the criteria in IFRS 15:9 after contract inception unless there has been a significant change in facts and circumstances. If the impacts of the COVID-19 pandemic result in a significant deterioration of a customer's or a portfolio of customers' ability to pay, the entity should reassess collectability. In case the reassessment results in the collectability criterion not being met, the entity is precluded from recognising further revenue under the contract until collectability becomes probable. Because of the significant uncertainty associated with the effects of the pandemic, it is important for the entity to document the judgements it made and the data or factors it considered.

- **Contract modification:** An entity may modify its enforceable rights or obligations under a contract with a customer. For example, the entity may grant a price concession to a customer. In that circumstance, the entity should consider whether the concession is due to the resolution of variability that existed at contract inception (i.e. a change in transaction price associated with variable consideration) or a modification that changes the parties' rights and obligations. A price concession that is provided solely as a result of the COVID-19 pandemic most likely represents a modification that changes the parties' rights and obligations. Conversely, a price concession that had always been envisaged as possible and was therefore already being treated as variable consideration continue to be accounted as such even though it may be triggered by COVID-19. An entity should consider if there have been modifications to contractual terms as a result of the COVID-19 situation? When were these modifications agreed with the customer (pre- or post-balance sheet date) and how should they be accounted for? Typically, modifications should not be accounted for until they are approved by both parties.

- **Assessment of performance obligations:** To cope up with the impact of COVID-19, various manufacturing entities may provide free goods or services, options to purchase additional, extended product warranties and after-market services (i.e., sale and delivery of maintenance, spare parts, and other value-added services). Will these goods and services be treated as separate performance obligations? If these goods and services are related to an existing contract with customer, will it qualify as contract modification?

- **Status of projects at the year end and subsequently:** Are the projects continuing as normal in the current environment or have they been delayed, suspended or postponed? Are there force majeure clauses in contracts which have been triggered by COVID-19-related events? Are projects now operating at lower efficiency levels than previously, and how will this impact the overall outturn of the project?

- **Recognition of revenue:** Because of potential supply disruptions or other circumstances, an entity may need to reconsider the timing of revenue recognition if it is unable to satisfy its performance obligations on a timely basis. Revenue cannot be recognised until control of the goods or services transfers to the customer (i.e. when the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the goods or services). Sometimes, delays in the transfer of goods or services may be caused by the customer or other external factors. For example, a customer may not be able to obtain physical possession of a product because of shipping delays or because it cannot receive the product (e.g. warehouse personnel may be unavailable). In such cases, an entity should carefully consider when control of the product transfers (e.g. before or after shipment). Further, if a customer is unable to take physical possession of the product, it may request that the entity retain the product on a bill-and-hold basis.

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

- **Variations and claims with customers:** the question arises to what extent any additional revenue can be taken into account due to delays, postponements or changes in scope? Entities should consider to what extent variations are enforceable under contractual terms that existed at the balance sheet date.
- Liquidated damages (or other penalties to the customer for delayed completion of projects) or other forms of variable consideration (i.e., incentives, price concessions, discounts on the purchase of future goods or services, free goods or services, extended payment terms or extensions of loyalty programmes). Do assumptions about variable consideration (such as liquidated damages, milestones or other bonuses/penalties) need to be updated in revenue calculations?
- **Significant financing component:** If the entity expects to provide extended payment terms to customers, or to require its customers to make an up-front payment (in order for the entity to fulfil its promised goods or services), will these impact management's assessment whether a significant financing component exists?
- Given changes in expected outturn of projects, might there be onerous contract provisions required, including projects delivered in collaboration with other parties?

More detailed information and considerations are included in Section 8- Revenue Recognition (IFRS 15) in the document.

3. Valuation of inventories

The COVID-19 pandemic may affect the recoverability of inventory balances. Some entities with inventories that are seasonal or are subject to expiration may have to assess whether a write-down for obsolescence or slow-moving stock may be necessary at an interim or annual period as a result of a slower sales pace. Other entities may have to assess whether a decline in their future estimated selling price is expected, which may require a write-down in the cost of inventory in an interim or annual period.

As per IAS 2 Inventories, inventories are measured at the lower of their cost and net realisable value ("NRV"). As a result of the pandemic, NRV of an item of inventory may fall below its cost for many reasons, including a decline in selling prices (e.g. as a result of price concessions offered to customers), or an increase in the estimate of costs to complete and market the inventories (e.g. increased costs to provide protection to employees).

In addition, manufacturing entities may have to reassess their practices for fixed overhead cost absorption if production volumes become abnormally low during the year as a result of plant closures or lower demand for their products. In case of abnormal reduction of an entity's production levels, an entity should not increase the amount of fixed overhead costs allocated to each inventory item. Rather, the unallocated fixed overhead costs are recognised in profit or loss in the period in which they are incurred.

If the entity presents an analysis of expenses by function, these costs are included as part of cost of sales.

Conversely, if an entity produces goods that are in high demand as a result of the pandemic (e.g. personal protection equipment), its production levels may be abnormally high. If this is the case, the entity will need to decrease the amount of fixed overhead allocated to each inventory item.

An entity will also need to consider whether certain costs incurred because of the pandemic can be capitalised.

These may include additional storage costs due to delays in delivery of inventories or costs of repackaging to make goods available in a different market with higher demand. IAS 2:16 gives the following as examples of costs that should be excluded from the cost of inventories and recognised as expenses in the period in which they are incurred:

- Abnormal amounts of wasted materials, labour, or other production costs;
- Storage costs, unless those costs are necessary in the production process before a further production stage;
- Administrative overheads that do not contribute to bringing inventories to their present location and condition; and
- Selling costs.

More detailed information and considerations on allowances for inventory obsolescence are included in Section 11- Changes in estimates in the document.

4. Impairment considerations for goodwill, tangible fixed assets and investments in associates and joint ventures

Reduced economic activity, lower revenues, factory closures or idling of manufacturing facilities, or trends related to decreases in consumer spending are likely to affect almost all entities in the UAE including manufacturing entities which may indicate impairment. Particularly, manufacturing entities are vulnerable given that the bulk of its workforce is employed in on-site jobs that cannot be done remotely and strict social distancing measures should be observed.

As such, certain manufacturing activities may be delayed or postponed and manufacturing entities may incur higher operating costs to continue its operations during the COVID-19 pandemic.

Management should consider various issues, including whether:

- COVID-19 and the measures taken to control it are likely to reduce future cash inflows, or increase operating and other costs, for the reasons described above;
- The assumptions and cash flow forecasts used to test for impairment should be updated to reflect the potential impact of COVID-19;
- 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; and
- The approach to determining discount rates might need to be revisited.

Sometimes, an entity may conclude that the affected tangible fixed assets will be sold, abandoned, or otherwise disposed of. Under IFRS 5 Non-current Assets Held for Sale and Discontinued Operations, if the held-for-sale criteria in are met, the entity is required measure the assets held for sale at the lower of its carrying amount and fair value less costs to sell.

In addition to the above, it should be noted that additional disclosures are likely to be required to enable users of the financial statements to understand the assumptions used and the sensitivity of the calculation to reasonable changes in those assumptions.

More detailed information and consideration is included under Section 5 - Impairment of Non-Financial assets in the document.

5. Liquidity considerations

Disruptions in production, reduced sales, decreases in pricing or volumes, due to issues such as price concessions, supply chain failures and work stoppages, could lead to potentially significant declines in cash flows, and they could therefore impact:

- The going concern assumptions;
- Liquidity risk disclosures; and
- Debt covenants.

The impacts on these items will need to be carefully monitored.

Refer to Section 1- Financial Stability and Going Concern in the document

6. Expected credit losses on trade receivables

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

IFRS 9 requires entities to use an expected credit loss ("ECL") model to measure impairment of most financial assets.

The model requires consideration of both historical and current information, as well as reasonable and supportable forecasts of future conditions (including macroeconomic information). Trade receivables are within the scope of the ECL model. Many companies in the industry use the simplified model for trade receivables and contract assets, and they measure the ECL at the lifetime expected credit losses.

Refer to Section 2 -Impairment of Financial Assets in the document

7. Impact on employee compensation plans

Manufacturing entities typically have a large workforce and significant end of service benefit obligations. There might be an impact on holiday pay accruals if large portions of the workforce defer holiday in this period. Management should also consider whether any of the assumptions used to measure the employee benefits have been impacted by the current global economic situation such as discount rate, salary continuation, salary increase, etc.

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