

## IFRS in Focus

### COVID-19 and financial reporting under IFRS Standards—what lies ahead

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#### Introduction

To say that financial reporting for the first half of 2020 has been challenging is an enormous understatement. Entities faced government-mandated shutdowns, supply chain disruptions and more. At the same time, they had to figure out how to close their books while their employees worked remotely.

This publication takes a strategic look at what are likely to be the most common hot topics for the upcoming financial reports, whether annual or interim. More information on the accounting considerations on these topics is available in [Deloitte's IFRS in Focus Accounting considerations related to the Coronavirus 2019 Disease](#).

#### Forecasts

Because of the ongoing uncertainties associated with the unprecedented nature of the COVID-19 pandemic, entities are likely to continue to face challenges related to developing assumptions and estimates for assessing the recoverability of non-financial assets (including goodwill), determining the recoverability of deferred tax assets (DTAs), and assessing their ability to continue as a going concern.

Effective COVID-19 forecasting includes reforecasting as frequently as needed. The frequency is likely to depend on the timing of the availability of new information that is deemed important to the forecast models or when new drivers are identified. As the chances for a V-shaped recovery fade, many economists believe that a U- or a W-shaped recovery is more likely. Entities often use different scenarios as part of their forecasting process.

While the effects of COVID-19 are broad, not all industries and not all entities within a specific industry are expected to be affected similarly. The pandemic's effect on an entity may be based on factors such as the products and services it offers, its supply chains, the availability of government assistance, actions it has taken in response to the pandemic, and its financial strength at the pandemic's outset. In addition, evolving factors such as new economic data, easing of lockdowns, continued work-at-home directives, and consumer behaviour and preferences are likely to affect significantly an entity's outcomes. Monitoring early indicators that differentiate those scenarios will be particularly important as entities seek to adapt their forecasts to the evolving COVID-19 business environment.

#### Impairment of non-financial assets, including goodwill

When events or changes in circumstances indicate that an asset may be impaired at the reporting date, an entity is required to test it for impairment even if the asset must also be tested annually for impairment (e.g. goodwill and indefinite-lived intangible assets). In the current reporting period, an entity is expected to contemplate the potential effects of COVID-19 on the impairment of its assets, which includes considering broad economic indicators as well as its specific facts and circumstances such as its industry, its geographic areas of operation and the actions it has taken or expects to take in response to the pandemic. While entities must routinely use judgement when testing assets for impairment, their need to use such judgement is amplified given:

For more information please see the following websites:

[www.iasplus.com](http://www.iasplus.com)

[www.deloitte.com](http://www.deloitte.com)

- The pandemic's wide-ranging impacts on business, consumer demand, and government actions (e.g. modelling the impacts of limitations related to travel, stay-at home directives, entitlement to government grants).
- The impact of events and changes in circumstances that occur after the date used to test assets for impairment.
- Indications of value evidenced by market capitalisation in periods of volatility.

Entities will be expected to monitor assets for indicators of impairment, to reach well-reasoned judgements based on their particular facts and circumstances, and to disclose their significant judgements and estimates.

### Deferred Tax Assets

Entities will need to assess their ability to realise DTAs before they expire. Adjustments to forecasted income (like those assumed for other impairment analyses), including forecasted future losses, will need to be factored into that recoverability assessment. Current and forecasted future losses, particularly those that result in a cumulative loss or the expectation of a cumulative loss, may significantly impair an entity's ability to use DTAs and, therefore, prevent the recognition of part or all of the DTAs.

### Going Concern

The potential prolonged disruption caused by COVID-19 may raise concerns about whether an entity is able to continue as a going concern for at least 12 months from the reporting date, taking into account the information available up to the date the financial statements are authorised for issue. Entities will need to consider the following among other factors:

- Changes in forecast results
- Potential liquidity and working capital shortfalls
- Their ability to access capital
- Contractual obligations
- Diminished demand for products and services

In addition, management must consider whether its plans, including potential government assistance, are able to mitigate the negative impacts on its business. While the effects of COVID-19 may be greater in certain industries (e.g. airlines, travel, hospitality), the current economic environment has significantly strained the ability of a number of entities to develop and maintain sustainable business models.

### Modifications to contractual arrangements

Many entities have modified contracts as part of addressing the reality that the impact of COVID-19 will be prolonged. Given the timing of the COVID-19 outbreak and related government-mandated or voluntary shutdowns, the upcoming financial statements may be the first that reflect the impact of these modifications. In a number of cases, changes to existing contractual arrangements raise accounting questions about whether such changes should be accounted for prospectively or at the time of change. Questions also arise in connection with changes to contractual terms, such as whether the changes (1) represent a new contract, (2) affect other existing contracts, and/or (3) affect accounting policies related to contracts executed in the future. We have observed a significant increase in changes to contractual terms associated with the accounting topics discussed below.

### Leases

In the wake of COVID-19, many entities have made, or are in the process of making, changes to various lease terms (e.g. timing of payments, amount of payments, and duration of agreements). In addition, the IASB has amended the leasing standard to provide relief to lessees when accounting for rent concessions resulting from COVID-19. Under such relief, instead of evaluating the concessions to determine whether they represent lease modifications, entities may choose to account for eligible concessions as if they were not lease modifications. More information on the recent amendment to the leasing standard is available in [Deloitte's IFRS in Focus](#) dedicated to that topic.

In addition, lessees may be required to test right-of-use assets for impairment.

### Revenue contracts

Some entities may seek to mitigate the effects of the pandemic by offering features such as price concessions, discounts on the purchase of future goods or services, free goods or services, extended payment terms, extensions of loyalty programs, opportunities to terminate agreements without penalty, or revisions to purchase commitments.

If revisions are made to a revenue contract, significantly different reporting outcomes may result depending on the nature of the changes. Entities must consider the specific facts and circumstances of changes in contractual terms (including their business practices and communications with customers) to determine whether to account for the impact of such changes at a single point in time (e.g. during the reporting period ended 30 June 2020) or over a longer period.

### Payment terms of loans or debt restructurings

Continued liquidity pressures related to COVID-19 have led to a greater number of debt restructurings (e.g. to extend maturity dates, reduce interest rates or ease covenant terms).

Lenders and borrowers will need to assess whether changes to a debt instrument represent a substantial modification, such that the existing instrument must be derecognised and a new one recognised at fair value resulting in a gain or loss.

Lenders will also need to consider the requirements of IFRS 9 *Financial Instruments* on how to apply the modification and impairment requirements when the modification of a financial asset does not lead to its derecognition.

### Collectability of financial assets

Entities may have collectability problems because of widespread business disruptions, financial difficulties and liquidity issues. As discussed below, concerns related to collectability extend beyond simply estimating how much cash will be collected.

### Allowance for expected credit losses

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.

The impact of COVID-19 on expected credit losses (ECL) will be particularly challenging and significant for banks and other lending businesses. Deloitte's [IFRS in Focus Expected credit loss accounting considerations related to Coronavirus Disease 2019](#) discusses certain key IFRS accounting considerations related to the accounting for ECL that may result from the COVID-19 pandemic.

The effect could also be significant for non-financial corporates. This is because ECL does not only apply to loans but also applies to many investments in interest-bearing financial assets (e.g. bonds and debentures), trade receivables, contract assets, lease receivables, issued loan commitments and issued financial guarantee contracts. The extent of these exposures in non-financial corporates may also be greater in individual company financial statements due to intra-group transactions such as intra-group loans or guarantees provided by the reporting entity on other entities' debt obligations.

### Trade receivables and revenue recognition

An amount may be deemed uncollectible for several reasons, such as credit risk or adjustments in the transaction price (e.g. price concessions, rebates, discounts). While differentiating between credit risk and adjustments in the transaction price may not affect the overall outcome of the collectability analysis (and thus the estimated value of accounts receivable), the presentation of such amounts could differ significantly (i.e. impairment loss vs. reduction of revenue) along with the related disclosure requirements depending on the deemed underlying cause (e.g. credit risk vs. price concession) of the collectability concern.

Collectability concerns about new, partly or fully completed customer contracts may limit the amount of revenue that can be recognised on existing and future contracts. Further, entities may determine that as a result of collectability concerns, an enforceable contract does not "exist" (as defined in IFRS 15 *Revenue from Contracts with Customers*) and thus that they are precluded from recognising revenue at all, even if they have fulfilled their obligations under the contract. In such instances, entities will need to evaluate further the criteria for revenue recognition since the timing of recognising revenue may be disconnected not only from an entity's performance under the contract but also from its receipt of cash.

### Restructuring, disposal costs and government assistance

The pandemic's prolonged impact has led entities to take proactive measures to sustain operations, such as seeking government assistance or other forms of relief and contemplating various restructuring activities.

### Employee terminations

Common measures that many companies have taken in response to the pandemic include implementing the terms of an existing termination plan, granting furloughs or temporary layoffs, offering one-time employee termination or relocation benefits, providing compensated absences, or a combination of these or different benefits and plans. Depending on the specific terms and conditions of such arrangements, costs or liabilities may be incurred that span several reporting periods or present unique accounting challenges. The period in which expenses are reflected for financial reporting purposes may vary from one entity to another as well, as within an entity, depending on the types of plans and benefits offered.

### Restructuring and assets disposal plans

Plans initiated by entities to address the pandemic may include facility closures, disposal of equipment, or sales of buildings. Since such plans may take the form of immediate disposal or continued partial operations until the time of disposal, they give rise to questions about the timing of when costs should be recognised and the assets presented as held for sale, the amount of costs to be recognised, and the presentation of those costs, all of which depend on the specific facts and circumstances associated with the activity.

### Government assistance and insurance recoveries

In response to the COVID-19 pandemic, governments in many jurisdictions are considering, or have implemented, legislation to help entities that are experiencing financial difficulty stemming from the pandemic. Entities will need to determine the appropriate timing for recognising such government assistance (including for the purpose of their impairment analysis and going concern assessment) and consider the information to be disclosed in the notes to the financial statements.

Entities may also have insurance coverage for actions such as suspended operations, event cancellations, costs associated with increased medical claims, asset impairments or shareholder litigation. Insurance recoveries are inherently uncertain and involve significant estimation. A reimbursement asset for this type of insurance coverage is recognised when its existence, rather than its amount, is virtually certain. This means that if an entity is virtually certain that it has insurance to cover certain costs, it will recognise a reimbursement asset if the range of possible recoveries is such that it can arrive at a reliable estimate of its amount.

### Presentation and disclosure

#### Judgements and estimates

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. For most entities, discussion of the inputs and assumptions used in developing forecasts and other significant judgements and estimates will be an area of increased focus.

There is no single view on how the COVID-19 pandemic will evolve and its impact on the economy. This uncertainty makes the need for full disclosure of judgements, assumptions and sensitive estimates significantly more important than usual, including in interim financial report.

#### Presentation of profit and loss

The impacts of COVID-19 are macroeconomic and affect all entities. Whilst the current environment may be unprecedented, it results from a series of events globally that are likely to have a wide range of potentially long-term consequences. Some of the impacts will give rise to discrete losses or expenses, such as those related to impairment losses or restructuring plans. However, there may also be other impacts such as an overall decrease in entities' profitability due to lower revenue and/or the continuance of salaries and other expenses while operations are closed or curtailed. Accordingly, the identification of the impacts of COVID-19 on an entity's performance may be difficult without use of arbitrary assumptions. Further, it would not be appropriate to present results in IFRS financial statements as though the impacts of COVID-19 had not happened on the grounds that the issue was not present in the comparative period. It will generally be more appropriate to include information that entities seek to provide to explain the impact of COVID-19 in the notes to financial statements or other financial communications.

#### Alternative performance measures

Entities may be considering disclosing new or adjusted alternative performance measures to reflect the impact of COVID-19 on their performance. In its [Statement on Importance of Disclosure about COVID-19](#) published on 29 May 2020, IOSCO advises entities that "[g]iven the uncertainty in the current environment, issuers should carefully evaluate the appropriateness of an adjustment or alternative profit measure. Not all COVID-19 effects are non-recurring and there may be a limited basis for management to conclude that a loss or expense is non-recurring, infrequent or unusual ... It could be misleading to describe an adjustment as COVID-19 related, if management does not explain how an adjusted amount was specifically associated with COVID-19. For example, we caution issuers from characterizing an impairment as COVID-19 related, where indicators of impairment existed prior to the pandemic that are unrelated to COVID-19. Additionally, characterizing hypothetical sales and/or profit measures (e.g., had it not been for the effect of COVID-19 the company's sales and/or profits would have increased by XX%) as non-GAAP financial measures would not be appropriate."

#### Further information

If you have any questions about COVID-19-related financial reporting considerations, please speak to your usual Deloitte contact or get in touch with a contact identified in this *IFRS in Focus*.

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- Deloitte's authoritative, up-to-date, iGAAP manuals which provide guidance for reporting under IFRS Standards; and
- Model financial statements for entities reporting under IFRS Standards.

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