

Applying IFRS

IFRS accounting
considerations of the
Coronavirus outbreak

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Building a better
working world

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As the outbreak continues to evolve, it is challenging at this juncture, to predict the full extent and duration of its business and economic impact. Consequently, these circumstances may present entities with challenges when preparing IFRS financial statements.

1. Background

With the recent and rapid development of the coronavirus outbreak, many countries have required entities to limit or suspend business operations and implemented travel restrictions and quarantine measures. These measures and policies have significantly disrupted (or are expected to disrupt) the activities of many entities. Disruptions are more immediate and pronounced in certain industries such as tourism, hospitality, transportation, retail, and entertainment, while there are also anticipated knock-on effects on other sectors such as manufacturing and the financial sector. As the outbreak continues to progress and evolve, it is challenging at this juncture, to predict the full extent and duration of its business and economic impact. Consequently, these circumstances may present entities with challenges when preparing their IFRS financial statements.

This publication provides a reminder of the existing accounting requirements that should be considered when addressing the financial effects of the novel coronavirus outbreak when preparing IFRS financial statements for the year ended 31 December 2019 (the reporting date). However, the principles described in this publication may also help entities with different reporting dates to assess the impact on their financial reports. The issues discussed are by no means exhaustive and their applicability depends on the facts and circumstances of each entity.

The financial reporting issues, reminders and considerations highlighted in this publication are the following:

- ▶ Events after the reporting period
- ▶ Going concern
- ▶ Fair value measurement
- ▶ Expected credit loss assessment
- ▶ Assets impairment
- ▶ Other financial statement disclosure requirements
- ▶ Other accounting estimates

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

2. Events after the reporting period

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

Recognition

The coronavirus outbreak occurred at a time close to the reporting date and the condition has continued to evolve throughout the time line crossing 31 December 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. Gradually more information became available.

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

To illustrate, entity A’s manufacturing facilities were shut down after 31 December 2019 due to the quarantine measures imposed by the local government to contain the outbreak. Management assesses whether the event is adjusting or non-adjusting. If, for example, management concludes that the cause of the shut down in the series of events that led to the shut down is not the outbreak itself, but rather the measures taken by the government after the reporting date, the event is non-adjusting and cannot be reflected in the assets and liabilities of the entity.

Disclosure

Even if management concludes none of the events are adjusting events, but the impact of these non-adjusting events are material, the entity is required to disclose the nature of the event and an estimate of its financial effect. For example, it may have to describe how the outbreak has affected or may affect its operations, such as whether there are any locations affected or operations suspended due to the governmental measures imposed, etc. In the early stages of the outbreak, the high level of uncertainties due to the unpredictable outcome of this disease may make it difficult to estimate the financial effects of the outbreak. If an estimate cannot be made, then the entity is required to disclose that fact.

How we see it

For many entities, most of the impact on business operations, assets and liabilities may not have been a direct consequence of the outbreak, but a result of the measures taken to contain it. Such entities may conclude the event did not provide evidence of conditions that existed at the end of the reporting period and assess it is non-adjusting. However, if the impact from the outbreak and the subsequent measures is material, the entities should disclose such events and an estimate of its financial impact (if practicable) or a qualitative description of its subsequent operating situations, in order to provide useful financial information for its primary users.

3. Going concern

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

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

In assessing whether the going concern assumption is appropriate, the standard requires that all available information about the future, which is at least, but not limited to, twelve months from the end of the reporting period, should be taken into account. This assessment needs to be performed up to the date on which the financial statements are issued.

Measurement

Management is required to assess the entity's ability to continue as a going concern. When making that assessment, where relevant, management takes into consideration the existing and anticipated effects of the outbreak on the entity's activities in its assessment of the appropriateness of the use of the going concern basis. For example, when an entity has a history of profitable operations and relies on external financing resources, but because of the outbreak, its operations have been suspended since January 2020, management would need to consider a wide range of factors relating to the current adverse situation and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate. Management should consider all available information about the future which was obtained after 31 December 2019.

Disclosure

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

How we see it

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

4. Fair value measurement

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

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

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

Measurement

When making the critical assessments and judgements for measuring fair value, the entity should consider what conditions and the corresponding assumptions were known or knowable to market participants.

The impact on FVM would depend on the evaluation of whether the severity of the outbreak at the reporting date would have impacted market participants' valuation assumptions at that date.

The impact on FVM would depend on the evaluation of whether the severity of the outbreak at the reporting date would have impacted market participants' valuation assumptions at that date. Accordingly, entities need to evaluate whether its severity, potential impact and the related valuation inputs were known or knowable by market participants by means of usual and customary due diligence performed up to that date.

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

Disclosure

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

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

How we see it

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

5. Expected credit loss assessment

IFRS 9 *Financial Instruments* requires an entity to incorporate reasonable and supportable information about past events, current conditions and the forecast of future economic conditions into the assessment of expected credit losses (ECL) for financial assets not measured at fair value through profit or loss. Such an assessment should be based on information at the reporting date and adjusted for subsequent available information where applicable. ECL is a probability weighted amount that is determined by evaluating a range of possible outcomes.

Measurement

Given that the initial cases of pneumonia of unknown origin were reported before 31 December 2019, when considering the IFRS 9 requirements to incorporate the forecast of future economic conditions on a probability weighted basis, from a technical standpoint, an entity should evaluate the likelihood of the occurrence of an event (i.e., in this case its severity and the potential impact leading to an epidemic) if this would significantly affect the estimation of expected losses of financial assets. In assessing the expected credit loss, management should consider reasonable and supportable information at the reporting date.

The implications could vary depending on an entity's specific situation and its methodology in assessing ECL. For example, financial institutions may incorporate estimates of forward-looking macro-economic factors into multiple scenarios about the future economy. The extent to which a subsequent spread of the disease would be factored into these possible scenarios, and the associated probabilities of such scenarios, will vary depending on characteristics of the financial asset, such as location and industry.

Disclosure

Entities should provide qualitative and quantitative disclosure to enable users of financial statements to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows. This includes the basis of inputs and assumptions and estimation techniques used, and how forward-looking information has been incorporated. If an entity considers it appropriate to incorporate in the ECL model an input or assumption or forward-looking adjustment associated with the outbreak, and if the effect of this is significant, or it is otherwise useful to understand the uncertainty of future cash flows, the entity should disclose such an input or assumption or forward-looking adjustment. If an entity changes its ECL methodology in order to better estimate the impact of the outbreak in accordance with the requirements of IFRS 9, the entity should disclose the change of the estimation technique and the reasons for its change.

Entities should provide qualitative and quantitative disclosure to enable users of financial statements to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows.

How we see it

ECL is a probability weighted amount that is determined by evaluating a range of possible outcomes. The impact from the outbreak may vary depending on an entity's specific situation and its methodology in assessing ECL. Accordingly, management should ensure that there is reasonable and supportable consideration of past events, current conditions and forecast of future economic conditions when making that assessment.

6. Impairment assessment

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

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

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

Measurement

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

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

In cases where the recoverable amount is estimated based on value in use, the considerations on accounting estimates apply. The forecasted cash flows should reflect management's best estimate of the economic conditions that will exist over the remaining useful life of the asset. Significant challenges can be expected on whether the forecast of or budgets for future cash flows prepared by management can be supported by the actual subsequent performance.

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

Disclosure

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

Entities should also pay attention to the disclosures and provide useful information to the financial statements' primary users. Management should consider disclosing the key assumptions and sensitivities, the amounts by which the values may change after incorporating certain consequential effects of change on the other variables used to measure recoverable amounts.

How we see it

Entities are required to determine whether the outbreak is considered to be an impairment indicator at the reporting date, which results in an impairment assessment. In respect of the impairment test that was performed at 31 December 2019, management needs to be mindful that the assumptions being used to determine the recoverable amounts reflected the conditions existing at that date. Entities need to consider providing detailed disclosures on the assumptions and sensitivities.

7. Other financial statement disclosure requirements

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

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

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

Disclosure

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. Given the significant impact on businesses after the reporting date as a result of the outbreak, some entities, before finalising their 2019 financial statements, may have already found the values or the recoverable amounts of certain assets subsequent to the reporting date significantly less than their carrying amounts as at 31 December 2019. Where such a decline in value is determined to be non-adjusting in accordance with the guidance described in the earlier sections, the entities do not adjust the carrying amounts, but instead, disclose such a fact and its financial effect if it can be reasonably estimated.

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

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

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

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

How we see it

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

8. Other accounting estimates

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

- ▶ Variable consideration and related constraints under IFRS 15 *Revenue from Contracts with Customers*
- ▶ Net realisable value of inventories under IAS 2 *Inventories*
- ▶ Recoverability of deferred tax assets under IAS 12 *Income Taxes*
- ▶ Remaining useful life and residual value of property, plant and equipment, intangible assets and right-of-use assets under IAS 16 *Property, Plant and Equipment*, and IAS 38 *Intangible Assets* and IFRS 16 *Leases*, respectively
- ▶ Provision for liabilities such as onerous contracts under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

Please refer to our 2017 publication [*Applying IFRS: Accounting for the financial impact of natural disasters*](#), which provides helpful guidance on many of the relevant accounting issues

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