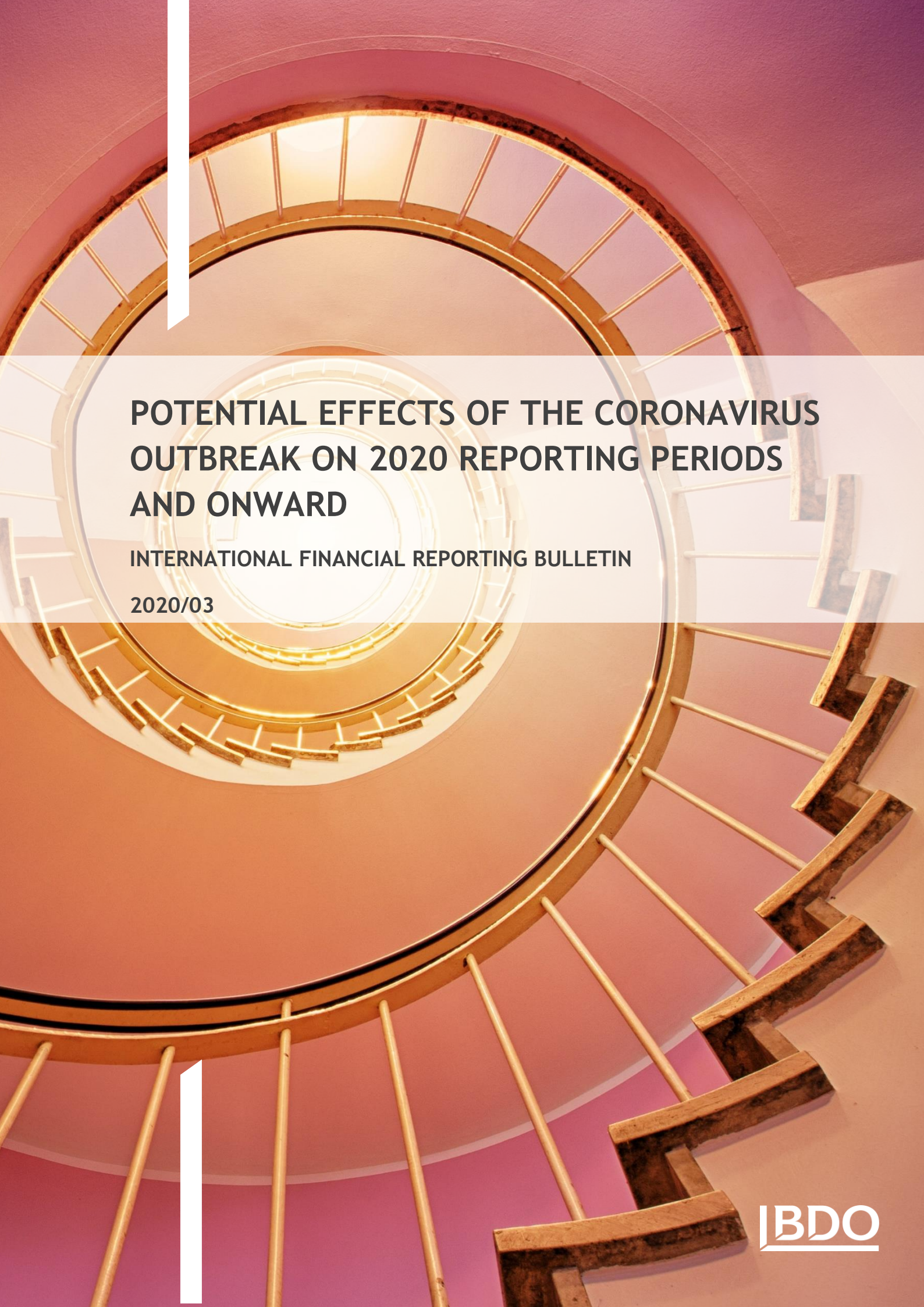


POTENTIAL EFFECTS OF THE CORONAVIRUS OUTBREAK ON 2020 REPORTING PERIODS AND ONWARD

INTERNATIONAL FINANCIAL REPORTING BULLETIN

2020/03

BACKGROUND

STATUS
Effects of the coronavirus outbreak are still developing on a daily basis. This IFR Bulletin is current as of 18 March 2020.

ACCOUNTING IMPACT
Widespread asset impairments along with myriad of effects on other financial statement line items; potential effect on going concern.

The 2019 Novel Coronavirus infection ('coronavirus') or 'COVID-19' outbreak poses a serious public health threat. It has interrupted the movement of people and goods throughout the world, and many levels of government are instituting restrictions on individuals and businesses. The resulting impact on financial reporting may be significant.

BDO issued IFR Bulletin 2020/02 – Potential effects of the Coronavirus Outbreak on 31 December 2019 year-end financial reporting (external publication) in February 2020.

In that publication, it was noted that significant development and spread of the coronavirus did not take place until January 2020. As at 31 December 2019, only certain events and associated actions had taken place such as the Wuhan Municipal Health Committee's issue on 30 December 2019 of an urgent notice in respect of the virus. However, although cases were reported to the World Health Organisation on 31 December 2019, its announcement of coronavirus as a global health emergency was not made until 31 January 2020 (following which national governments took action). In addition, significant measures taken by the Chinese government and by private sector organisations did not take place until early 2020.

On this basis, the effects of the coronavirus were generally a 'non-adjusting event' (IAS 10.10-11), and therefore forecasts, projections and associated assumptions used in preparing financial statements as at 31 December 2019 would reflect either little or no change as a result of the coronavirus outbreak.

For reporting periods beginning on or after 31 January 2020, the effects of the coronavirus would need to be incorporated into the preparation of financial statements.

The effects of the coronavirus may be very wide spread, and relate to many industries; they are not limited only to entities operating directly in the travel and tourism industry (e.g. airlines, tour operators, etc.). Coronavirus may affect entities in nearly every sector, due to the following impacts:

- Reduced consumer demand for goods and services due to lost income and/or restrictions on consumers' ability to move freely;
- Lack of investment in capital improvements and construction reducing demand for many goods and services;
- Reduction in market prices for commodities and financial assets, including equity and debt instruments; and
- Disruption of global supplies chains due to restrictions placed on the movement of people and goods.

The financial reporting implications for entities may be similarly broad, and the precise effects will depend on the facts and circumstances of each entity. As time elapses and the effects of the outbreak change and evolve, it may become difficult to distinguish which information and facts and circumstances should be incorporated into measurement as at period end and which should result in potential subsequent event disclosure. The following are financial reporting considerations that entities and engagement teams need to consider.

Impairment of assets and provisions

IFRS Standard	Potential impact of the coronavirus	BDO Comments
IFRS 9, *Financial Instruments*	• Increase in expected credit losses; • Modifications to financial assets and liabilities (e.g. concessions to payment terms); • Losses incurred on financial guarantee contracts accounted for under IFRS 9 to third parties or related parties (e.g. cross-guarantee of a related party loan); • Decrease in hedge effectiveness or disqualification from continuance of hedge accounting due to forecasted transactions no longer being highly probable.	Expected credit losses may increase due to an increase in both the probability of default ('PD') and the loss given default ('LGD') for financial assets. As all financial assets subject to ECL require the PD to be estimated over the next 12 months, the effects of uncertainty relating to coronavirus may be very significant. Additionally, the effects of the coronavirus may trigger a significant increase in credit risk, and therefore the recognition of a lifetime ECL provision on many financial assets. Lenders and borrowers may also enter into agreements to modify the terms of financial instruments such as bank loans. These modifications may take the form of reduced interest rates, modification to payment terms and 'grace periods' for covenant violations. Entities should consider the requirements of IFRS 9 for the modification of assets (for lenders) and liabilities (for borrowers). These modifications will generally give rise to gains for borrowers and losses for lenders.
IAS 36, *Impairment of Assets*	• Indicators of impairment may exist for assets subject to impairment only when such indicators exist (e.g. property, plant and equipment, right-of-use assets, certain intangibles, etc.); • Value in use calculations may need to be adjusted (e.g. revised cash flows and/or adjusted discount rate). • Fair value less costs of disposal may decrease and active markets for certain types of assets may disappear.	Similar to an assessment of going concern (see the following section), cash flows included in either a value-in-use or a fair value less costs of disposal calculation need to consider all available information. Given the disruption to operations, the cash flow forecasts will need to incorporate extremely severe 'down side' forecasts. The effect will vary depending on industry sector; for leisure, travel and retail a reasonable starting point may be the effect of a country 'lockdown' for a period of 2-3 months with little or no revenue being generated during this time.
IAS 2, *Inventories*	• Net realisable values may decrease, resulting in increased impairment; • If production is decreased, entities must consider that fixed overheads are allocated based on 'normal capacity'.	If an entity ceases production or significantly reduces production for a period of time, significant portions of fixed production overheads (e.g. rent, depreciation of assets, some fixed labour, etc.) will need to be expensed rather than capitalised, even if some reduced quantity of inventory continues to be produced.
IFRS 6, *Exploration for and Evaluation of Mineral Resources*	If the reporting entity has elected to capitalise exploration and evaluation assets, indicators of impairment may exist (see points under IAS 36).	Given the significant decrease in global commodity prices, significant impairment of exploration and evaluation assets is expected.

IFRS Standard	Potential impact of the coronavirus	BDO Comments
IAS 28, *Investments in Associates and Joint Ventures*	• Reductions in the carrying value of investments accounted for in accordance with the equity-method due to losses incurred; • Possible impairment of carrying value of investment; • Entities may be required to record liabilities for losses incurred beyond the carrying value of their investment.	Before applying the equity method, an entity must first recognise expected credit losses in accordance with IFRS 9 if an investment in an associate or joint venture includes a long-term interest that is subject to ECL (e.g. a loan to the investee). After an investor has recorded its share of income from an associate or joint venture as required by the equity method, the remaining carrying value of the investment is still subject to further impairment requirements. An entity applies IAS 36 to the remaining carrying value. After the carrying value of an interest in an associate or joint venture is reduced to zero, additional losses and a liability are accounted for if the investor has a legal or constructive obligation to make payments on behalf of the associate or joint venture. The effects of the COVID-19 outbreak may make this type of arrangement more common.
IAS 12, *Income Taxes*	Deferred tax assets may not meet recoverability requirements and therefore may not meet the recognition criteria in IAS 12.	Similar to an assessment of going concern (see the following section), an assessment of the likelihood of an entity being able to recover the value of deductible temporary differences needs to consider all available information. Given the disruption to operations, forecasts may need to incorporate extremely severe 'down side' forecasts. Tax losses and other deductible temporary differences having no fixed expiry or a very long-term expiry (e.g. 20 years) is not justification for the recognition of associated deferred tax assets.
IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*	• Onerous contracts may exist for contractual or constructive obligations (e.g. revenue contracts, purchase contracts for which no benefit will now be obtained by the entity); • Insurance recoveries relating to losses incurred due to the outbreak may not meet recognition requirements in a reporting period (i.e. recovery may not be 'virtually certain').	While IAS 37 does not permit the recognition of future operating losses as liabilities, losses arising from onerous contracts may increase as the unavoidable costs may exceed the economic benefits derived from the contract. For example, if an entity is obligated to pay costs for a conference held after the end of the reporting period, but it has cancelled the conference due to the COVID-19 outbreak, the cost of the conference would be recognised as a liability at the time of cancellation as it would be an onerous contract (i.e. unavoidable costs exceed the economic benefits).

Going concern

As required by IAS 1 *Presentation of Financial Statements*, it is management's responsibility to make an assessment of an entity's ability to continue as a going concern and provide appropriate disclosures relating to how that assessment was performed and its results. Financial statements in accordance with IFRS are prepared on a going concern basis unless management either intends to liquidate the entity or to cease trading, or there is no realistic alternative to do so (IAS 1.25). In making this assessment, management must consider all available information about the future, which must extend at least 12 months into the future. If information is available beyond 12 months that is relevant in management's assessment, then it must be included as well. In some jurisdictions, local regulatory requirements require consideration to be given to a period of at least twelve months from the date of approval of the financial statements. This means that in those jurisdictions the 'look forward' period will be longer than that required by IAS 1.

The assessment of going concern under the effects of the coronavirus outbreak will need to incorporate unprecedented shocks to forecasts. The decreases in asset values, decline in demand for goods and services and supply chain disruptions may be dissimilar to any previously encountered 'real world' scenario, making forecasting the precise results difficult. While the requirements of IAS 1 are not prescriptive as to how management's assessment is performed, in circumstances where significant uncertainty exists surrounding the outcome of future events, it may be appropriate to model multiple scenarios and weigh their likelihood. In some sectors, 'worst case' scenarios included in an assessment may have to consider little to no revenue for extended periods of time if entities are required to cease trading operations. 'Negative' or 'worst case' scenarios may also need to be weighted quite heavily due to the level of uncertainty as to how the effects of the outbreak will unfold and how long they will endure.

The effects of the coronavirus are likely to affect the level of uncertainty that may exist in an assertion that the entity will be able to continue as a going concern. Regardless of the result of management's assessment, many entities will need to disclose key judgments and and estimates it used to arrive at this conclusion. Key areas in a going concern assessment may include:

- The sources of assumed liquidity and cash flows, especially in instances where the entity does not have access to sufficient funds and financing to continue operations based on current contractual arrangements;
- Assumption surrounding compliance with covenants, contractual agreements and/or regulatory requirements;
- Forecasts of future revenue, especially in instances where demand for the entity's primary activities may be significantly reduced for the foreseeable future;
- Assumptions surrounding the length of time and severity to disruptions in supply chains and/or suspension of operations; and
- Support from various levels of government, including intervention on operations and/or financial assistance.

General financial statement presentation, measurement and disclosures

IFRS Standard	Potential impact of the coronavirus	BDO Comments
IAS 1, *Presentation of Financial Statements*	• See going concern section above. • Classification of assets and liabilities as current or non-current. Assets may no longer be consumed or settled in an entity's 'normal operating cycle'. Liabilities may become due on demand due to breaches of contractual terms and covenants	One of the criteria allowing non-current presentation of a liability is based on the entity having an unconditional right to defer settlement for at least 12 months. Therefore, the classification of liabilities is driven by rights rather than an entity's expectation of the timing of settlement.

IFRS Standard	Potential impact of the coronavirus	BDO Comments
IAS 1, Presentation of Financial Statements (continued)	and therefore will be classified as current liabilities.	In contrast, a number of the criteria for current asset classification are based around expectations of when the asset will be realised, settled or consumed.
IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*	• Sales of non-current assets or disposal groups may not meet the 'highly probable' criteria to be classified as held for sale due to disappearance of existing market and/or necessary buyers; • If entities reduce operations, components that are disposed of or cease operations may meet the definition of discontinued operations and require separate presentation and disclosure. However, non-current assets or disposal groups that are to be abandoned and not sold are not permitted to be classified as held for sale.	Conversely, it is also possible that more assets may be classified as non-current assets held for sale if the effects of the outbreak require entities to liquidate certain assets.
IFRS 7, *Financial Instruments: Disclosures*	• Risks arising from financial instruments may require extensive disclosure. • Disclosure of credit risk arising from financial assets (e.g. loans receivable, trade receivables, etc.), may need to be expanded significantly due to significant judgments and estimates; • Disclosure of liquidity risk may need to be expanded, especially in instances where a lack of liquidity may significant impact an entity's to continue its operations; • Disclosure of market risks may need to be expanded when the entity's operations are significantly affected by changes in market risks (e.g. currency, interest rate and other price risks); • Disclosure of defaults and breaches of loans payable require disclosure surrounding the details of the default.	IFRS 7 requires entities to disclose quantitative and qualitative information about the nature and extent of risks arising from financial instruments. This information is required to be sufficient to enable users of financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed. Significant increases in multiple financial risks may exist, some of which may not have been significant in past financial statements. Entities should carefully examine the nature of the risks they are exposed to and ensure their updated disclosures communicate risk exposures and their sensitivities.
IFRS 13, *Fair Value Measurement*	• Fair value is an 'exit price' in an 'orderly' transaction. The effects of the virus may make it challenging to estimate the price that would be obtained due to highly volatile markets and/or a lack of an active market existing;	Current market conditions may appear to be a 'distress sale', however, if such conditions exist broadly in the market, then those factors should be incorporated into a fair value measurement. It would generally be inappropriate to adjust a measure for expected 'rebounds' in value.

IFRS Standard	Potential impact of the coronavirus	BDO Comments
IFRS 13, *Fair Value Measurement (continued)*	• The level in the fair value hierarchy for inputs into fair value measurements may shift, in particular from level 2 to level 3 with associated enhanced disclosures.	For financial instruments with level 1 prices (quoted on an active market), even if there is a significant decline in activity on that market this does not mean that the price has become unobservable.

Other financial reporting issues

IFRS Standard	Potential impact of the coronavirus	BDO Comments
IFRS 15, *Revenue from Contracts with Customers*	• Refunds or concessions offered to customers may introduce variable consideration into the measurement of the contracts; • Other conditions that may give rise to variable consideration (e.g. success-based fee) may be less likely to be achieved, resulting in less revenue being recognised; • Fulfilment costs and contract acquisition costs recognised as an asset may be impaired.	IFRS 15 'constrains' the amount of revenue to be recognised when the contract includes variable consideration. Some entities may have to account for a significant portion (if not all) consideration received or receivable as a contract liability, rather than revenue, if significant uncertainty exists surrounding whether the entity will have to refund the consideration in the future.
IFRS 16, *Leases*	• Possible impairment to right-of-use assets (see IAS 36 section); • The likelihood of exercising lessee options may result in lease term reassessments and resulting remeasurements; • The assessment of when 'no more than an insignificant penalty' exists for both the lessee and the lessor (IFRS 16.B34) may change, which could result in a changes in the lease term and resulting remeasurements; • Impairment of lease receivables for lessors (see IFRS 9 section); • Accounting for lease modifications (e.g. concessions by landlords to tenants when operations are interrupted).	Landlords may offer concessions to tenants (e.g. rent free periods, deferral of payment, cash payments from lessors to lessees, etc.) to compensate them for disruptions to operations, particularly in shopping centres. Determining how to account for such concessions will depend on the precise terms of the lease contract and the nature of the concessions.
IAS 19, *Employee Benefits*	• The fair value of plan assets may decrease significantly; • Termination benefits for employees will need to be determined. The timing of when to recognise a liability for such benefits may require careful analysis.	Termination benefits are recognised at the earlier of (i) when the entity can no longer withdraw the offer; and (ii) the entity recognises costs for a restructuring that is within the scope of IAS 37 and involves payment of such benefits. An entity is typically unable to withdraw an offer once it has been communicated to the affected employees in sufficient detail.

IFRS Standard	Potential impact of the coronavirus	BDO Comments
IFRS 2, *Share-based Payment*	• The assessment of whether certain types of vesting conditions will be satisfied may change. • Modifications to share-based payments may need to be accounted for.	Service conditions (e.g. number of years of service with the company) and other performance conditions (e.g. if an IPO is successful) may not be met, resulting in 'forfeiture' accounting if they are not satisfied, with the previously accumulated expense reversed in profit or loss. Performance conditions (e.g. a target market price for the entity's equity instruments) do not result in forfeiture accounting if they are not satisfied.

IAS 34 Interim financial reporting

For entities that prepare interim financial statements in accordance with IAS 34, several specific points should be noted. While interim financial statements do not contain all the information and disclosures as an annual financial statement, IAS 34.15 does require entities to disclose 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.

As noted in the previous sections, many aspects of an entity's financial reporting may be significantly affected by the coronavirus outbreak, which would require significant disclosure in an interim financial statement. As the disclosure requirement in IAS 34 is made by reference to the last annual financial statements, entities that prepare their first interim financial statement since the annual period preceding the coronavirus outbreak (e.g. 30 June 2020 interims for an entity with a calendar year-end) will need particularly comprehensive disclosures to enable a user of the financial statements to understand the effect of the outbreak on its financial reporting.

IAS 34 requires the same accounting policies to be applied in interim financial statements as annual financial statements, and the frequency of an entity's reporting should not affect the measurement of results in either an annual or an interim financial statement. That is, the application of the requirements of IFRS are not reversed in a subsequent annual financial statement unless permitted by the applicable IFRS. For example, impairment recorded relating to property, plant and equipment in an interim financial statement may be reversed in subsequent interim or annual financial statements, as IAS 36 permits such a reversal. However, IFRIC 10, *Interim Financial Reporting and Impairment* states that no such reversal may occur for goodwill, as IAS 36 does not permit an impairment recorded against the value of goodwill to be reversed.

If indicators of impairment exist for CGUs that contain goodwill, then goodwill will need to be tested for impairment in an interim period, even if that does not align with the annual testing cycle for goodwill. This is because any impairment to a CGU is first allocated to goodwill.

Regulatory and Filing Obligations

Various regulators have acknowledged the impact of the outbreak on reporting entities worldwide. Public statements made by various regulators have the following generally consistent messages:

- Expectation of full and frank disclosure of the impact of the outbreak on entities in the financial statements, MD&A and other required communications;
- A desire to ensure that audit quality is not reduced due to logistical and practical difficulties that may be encountered due to the outbreak. Some regulators have stated that auditors need to ensure they take appropriate time and audit procedures may need to be modified; and

- Some reliefs being offered relating to the deadlines by which financial statements and other regulatory filings are required to be submitted for entities that have encountered significant barriers in doing so.

See the Appendix to this publication for links to some of the communication issued by regulators and professional bodies worldwide.

Appendix – Statements made by Regulators and Professional Bodies

Date Issued	Jurisdiction	Regulator	Link
19 February 2020	United Kingdom	Financial Reporting Council (FRC)	FRC advice to companies & auditors on coronavirus risk disclosures
19 February 2020	United States	Securities and Exchange Commission (SEC)	Statement of continued dialogue with audit firm representatives on audit quality in China and other emerging markets: coronavirus – reporting considerations and potential relief
27 February 2020	United Kingdom	Institute of Chartered Accountants in England Wales	COVID-19: Considerations for Group Auditors
4 March 2020	Germany	Institut der der Wirtschaftsprüfer (IDW) – Institute of Public Auditors in Germany	(In German): Effects of the spread of coronavirus on the accounting as of 31 December 2019
4 March 2020	United States	Securities and Exchange Commission (SEC)	SEC provides condition regulatory relief and assistance for companies affected by the coronavirus disease 2019 (COVID-19)
11 March 2020	European Union	European Securities and Markets Authority (ESMA)	ESMA recommends action by financial market participants for COVID-19 impact
16 March 2020	Canada	Canadian Securities Administrators (CSA)	Canadian securities regulators provide update on COVID-19 and potential filing delays by reporting issuers
16 March 2020	Hong Kong	Securities and Futures Commission (SFC)	Further guidance on the joint statement in relation to results announcements in light of the COVID-19 pandemic
16 March 2020	Australia	Australian Securities & Investments Commission (ASIC)	ASIC takes steps to ensure equity market resiliency



This publication has been carefully prepared, but it has been written in general terms and should be seen as broad guidance only. The publication cannot be relied upon to cover specific situations and you should not act, or refrain from acting, upon the information contained therein without obtaining specific professional advice. Please contact your respective BDO Member Firm to discuss these matters in the context of your particular circumstances. Neither BDO IFR Advisory Limited, Brussels Worldwide Services BV, BDO International Limited and/or BDO Member Firms, nor their respective partners, employees and/or agents accept or assume any liability or duty of care for any loss arising from any action taken or not taken by anyone in reliance on the information in this publication or for any decision based on it.

Service provision within the international BDO network of independent Member Firms ('the BDO network') in connection with IFRS (comprising International Financial Reporting Standards, International Accounting Standards, and Interpretations developed by the IFRS Interpretations Committee and the former Standing Interpretations Committee), and other documents, as issued by the International Accounting Standards Board, is provided by BDO IFR Advisory Limited, a UK registered company limited by guarantee. Service provision within the BDO network is coordinated by Brussels Worldwide Services BV, a limited liability company incorporated in Belgium with its statutory seat in Zaventem.

Each of BDO International Limited (the governing entity of the BDO network), Brussels Worldwide Services BV, BDO IFR Advisory Limited and the Member Firms is a separate legal entity and has no liability for another such entity's acts or omissions. Nothing in the arrangements or rules of the BDO network shall constitute or imply an agency relationship or a partnership between BDO International Limited, Brussels Worldwide Services BVBA, BDO IFR Advisory Limited and/or the Member Firms of the BDO network.

BDO is the brand name for the BDO network and for each of the BDO Member Firms.

© 2020 BDO IFR Advisory Limited, a UK registered company limited by guarantee. All rights reserved.

www.bdo.global