COVID-19 Pandemic: Guidance Notes on the Implications on Financial Reporting

Background:

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 jurisdictions have imposed restrictions on individuals and businesses. The resulting impact on financial reporting may be significant for many of the business organisations. The effects of the COVID - 19 may be very wide spread, and relate to many industries.

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 needs to be incorporated into the measurements as at the end of the reporting period and which shall result in potential subsequent event disclosures supported by several changes in estimates, assumptions and other analyses in a more descriptive manner. This pronouncement intends to provide guidance on the implications to financial reporting due to the COVID 19 outbreak considering the following areas:

01. Financial Instruments;
02. Fair Value Measurement of Equity and Debt Instruments;
03. Impairment of Assets;
04. Going Concern;
05. Events After the Reporting Period;
06. Measurement of Deferred Taxes.

01. Financial Instruments

01.01 Disclosures in relation to the financial instruments

Issue:

There is a need to consider what sort of additional disclosures would be required in the financial statements with the COVID 19 incident.

Analysis:

With the objective of evaluating the nature and extent of risks arising from financial instruments to which the entity is exposed and how to manage those risks; SLFRS 7 *Financial Instruments: Disclosures* requires the entities to disclose quantitative and qualitative information about the nature and extent of risks arising from financial instruments, which would sufficiently enable users of financial statements to evaluate the nature and extent of the exposed risks arising from financial instruments.

Paragraph 32 of SLFRS 7 states that the disclosures on the risks on financial instruments would include credit risk, liquidity risk and market risk, and how such risks have been managed. Further, paragraph 32A emphasizes that the qualitative disclosures in the context of quantitative disclosures enables users to link related disclosures and hence form an overall picture of the nature and extent of risks arising from financial instruments to evaluate the exposure to such risks. In addition, paragraph 34(c) requires to disclose the concentrations of risks that it has been exposed to.

Recommendation:

An entity is required to disclose the nature and extent of risks arising from financial instruments and how it manages those risks. Therefore, the entity would need to explain the significant impact (including the potential impact) of COVID-19 on the risks arising from financial instruments and how it intends to manage 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. Accordingly, an entity needs to provide extensive disclosures in relation to the expansion of the exposures to credit risks as a result of significant judgments and estimates on the possibilities of defaults and breaches of contracts; liquidity risks due to liquidity issues that affect continuity of operations; and market risks due to factors such as exchange rates, interest rates and other price risks supported by sensitivity analyses.

The assumptions and information used in making estimates such as Expected Credit Loss (ECL), policies and procedures for valuing collaterals need to be clearly disclosed in the financial statements. Quantitative and qualitative information that allows evaluation of the amounts arising from ECLs also need to be provided. The types of analysis disclosed previously may need to be adjusted or supplemented to clearly convey impacts arising from COVID-19. Further, the identified concentrations in the areas that are affected by the outbreak need to be updated in terms of disclosures.

01.02 Accounting for Moratoriums to Grant Concessions

Issue:

In several circumstances, moratoriums have been granted to on loans and advances covering certain business sectors and the entities have to decide how to apply SLFRSs in accounting for such relief measures offered.

Analysis:

(i) Interest Revenue Recognition:

Paragraph 5.4.1 of SLFRS 9[0] states that the interest revenue shall be calculated by using the effective interest method (EIR) to the gross carrying amount. Further, paragraph 5.4.2[2] prescribes how to calculate the interest revenue for credit impaired financial assets.

(ii) Rescheduled Loans, Advances and Leased Assets:
Paragraphs 5.4.3[3] and B5.5.27[4] of SLFRS 9 have to be applied where there is a modification to the existing loan has been taken place which does not result in a derecognition of the initial loan.

Borrower may need to assess whether the financial assets need to be derecognised under paragraph 3.2.3(a); Accordingly, the derecognition takes place, when and only when the contractual rights to the cash flows from the financial assets expire. On that basis, derecognition on the revised terms would occur where the moratorium results in substantial modification to the original cash flows which could be seen as an expiry of those cash flows. Further, as per paragraph B5.5.25 of SLFRS 9, in some circumstances the renegotiation or modification of the contractual cash flows can lead to the derecognition of the existing financial asset. In that case, subsequent recognition of the **modified financial asset is considered a 'new' financial asset**. Accordingly, in terms of paragraph B5.5.26, the date of the modification shall be treated as the date of initial recognition of that financial asset when applying the impairment requirements to the modified financial asset. This typically means that **measuring the loss allowance at an amount equal to 12-month expected credit losses until the requirements for the recognition of lifetime expected credit losses** in paragraph 5.5.3 **are met**. However, in some circumstances following a modification results in derecognition of the original financial asset; there may be evidence that the modified financial asset is credit-impaired at initial recognition, and thus, the financial asset shall be recognised as an originated credit-impaired financial asset.

Recommendation:

(a) Interest Revenue Recognition:
Interest revenue shall be calculated by using the effective interest method applied to the gross carrying amount of a financial asset. However, if such asset subsequently becomes credit impaired, amortised cost (gross carrying amount net of credit allowances) has to be considered in applying the effective interest rate until the credit risk improves and the asset migrates back to stage 2 or stage 1.

Accordingly, even if the interest is deferred for a certain shorter period of time, interest income has to be accrued in the financial statements. In addition, if the financial asset

becomes credit impaired due to the COVID 19 incident, EIR should be calculated on net carrying value.

(iii)Rescheduled Loans, Advances and Leased Assets:

SLFRS 9 requires the application of judgement and allows entities to adjust their approach to determining ECLs in different circumstances. A number of assumptions and linkages underlying the way ECLs have been implemented to date may no longer hold in the current environment. Entities shall not continue to apply their existing ECL methodology mechanically.

The extension of payment holidays to all borrowers in particular classes of financial instruments shall not automatically result in all those instruments being considered to have suffered a Significant Increase in Credit Risk (SICR). Consideration also need to be given on whether the concessions under moratoriums could enable certain borrowers to resume regular payments in the foreseeable future (whom otherwise would have fallen into financial difficulty), such that significant increase in credit risk would not occur over expected remaining lives of the receivables. Identifying SICR is usually material for banks and other financial institutions. As such, explicit probabilities of default (PDs) would be calculated for individual exposures and those would be used to perform quantitative assessments of SICR. It is necessary to consider whether they can incorporate COVID-19-related changes in the risk of default into PDs for individual exposures on a timely basis.

However, when there is a **substantial modification to the original cash flows** that could be seen as an expiry of those cash flows, it may lead to **derecognition of the financial assets, and will be considered as 'new' financial assets**. In such circumstances, the loss allowance is measured at an amount equal to 12-month expected credit losses unless such asset is credit impaired that requires to recognize lifetime expected credit losses.

Circumstances that lead to renegotiation or modification of contractual cash flows of a financial asset that does not result in derecognition shall be classified under an appropriate stage considering the entity’s assessment on the basis of all reasonable and supportable information as to whether there has been a significant increase in credit risk since initial recognition, until the time of modification and thereafter in subsequent the reporting periods. In such circumstances, it is required to recalculate the gross carrying amount as the present value of the renegotiated or modified contractual cash flows that are discounted at the original effective interest rate and to recognise a modification gain or loss in profit or loss. In this context, aforementioned ‘time of modification’ shall be considered as the period in which the specific event or occasion took place and not the date or period of modification of loan.

(b) Disclosure requirements:

General disclosures in terms of SLFRS 7 need to be followed in the financial statements. In addition to the general disclosures required, with regard to impairment requirements of financial assets which have had modifications to their contractual cash flows need to provide disclosures required by 35F(f), 35I(b) and 35J paragraphs of SLFRS 7.

A company is required to disclose the nature and extent of risks arising from financial instruments and how it manages those risks. Therefore, 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.

Examples of specific disclosures include the following.

- Information about an entity'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. For example, an entity 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, 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 entity 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 (paragraph 125 of LKAS 1).

01.03 Segmentation of Portfolios and ECL Assessment

Issue:

Due to the disruptions in the business operations, some business entities might have impact on the credit quality across the value chain which lead to issues in the liquidity and credit quality. That may require need to segment the portfolios and revise ECL assessment as appropriate.

Analysis:

Paragraph 5.5.17 of SLFRS 9 states that an entity shall measure expected credit losses of a financial instrument in a way that reflects: an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes; the time value of money; and reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions. Further, according to paragraph B5.5.28, ECL are a probability-weighted estimate of credit losses (ie the present value of all cash shortfalls) over the expected life of the financial instrument. Further, in terms of paragraph B5.5.35, an entity may use practical expedients when measuring expected credit losses if they are consistent with the principles in paragraph 5.5.17 such as use of provision matrix. Accordingly, depending on the diversity of its customer base, the entity would use appropriate groupings (based on the geographical region, product type, customer rating, collateral or trade credit insurance and type of customer), if its historical credit loss experience shows significantly different loss patterns for different customer segments.

Recommendation:

ECL measurements need to incorporate forward-looking information that is available without undue cost or effort at the reporting date. This may be particularly challenging to do for the economic impact of COVID-19. For the purpose of measuring ECLs and for determining whether significant increase in credit risk (SICR) has occurred, an entity shall group financial instruments on the basis of shared credit risk characteristics and reasonable and supportable information available on a portfolio basis which may require considering re-segmenting of the portfolios. However, in circumstances where reasonable and supportable information are not available in a structured manner; the management may exercise its judgement taking into account their **past experience, business model and the internal credit risk management framework** in determining whether the presumption as per SLFRS 9 can be rebutted. Further, in taking such a determination, the regulatory provisions also need be taken into consideration.

Changes in economic conditions shall 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. In addition, a breach of the covenants of a credit contract is a possible indication of unlikeliness to pay under the definition of default. However, a covenant breach does not automatically trigger a default. Rather, it is important to assess covenant breaches on a case-by-case basis and determine whether they indicate unlikeliness to pay.

Any changes made to ECL to estimate the overall impact of Covid-19 will be subject to very high levels of uncertainty as so little reasonable and supportable forward-looking information is currently available on which to base those changes. This makes it even more important that ECL is implemented well and on the basis of the most robust reasonable and supportable

assumptions possible in the current environment. To mitigate the risk, it is critical that entities make well-balanced and consistent decisions that consider not just the potential impact of the virus, but also take full account of the unprecedented level of support provided by governments and central banks to protect the economy in the form of tax reliefs and moratoriums. Accordingly, due weight will need to be given to established long-term economic trends, given the challenges of preparing detailed forecasts far into the future.

02. Fair value measurement of Equity and Debt Instruments

Issue:

COVID 19 pandemic has created a situation where the volume or level of activities for several assets and liabilities to be curtailed resulting their values to significantly decrease along with the reduced market activities in an active manner.

Analysis:

In terms of SLFRS 13 *Fair Value Measurement,* when measuring fair value, an entity shall take into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. According to paragraph B37 of SLFRS 13, fair value of an asset or a liability might be affected when there has been a significant decrease in the volume or level of activity for that asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities) and paragraph B38[(5)] provides further guidance.

Accordingly, such further analysis concludes one of the following circumstances:

(a) The transaction or quoted price still represents fair value. i.e. decline in volume/activity, on its own, may not indicate that the quoted price does not represent fair value.
(b) The transaction or quoted price does not represent fair value. In such cases, an adjustment is required if;

  - those prices are still used as the basis for measuring fair value and the adjustment may be significant to the fair value measurement;
  - other circumstances necessitate the adjustment – for example, when a price for a similar asset requires significant adjustment to make it comparable to the asset being measured or when the price is stale.

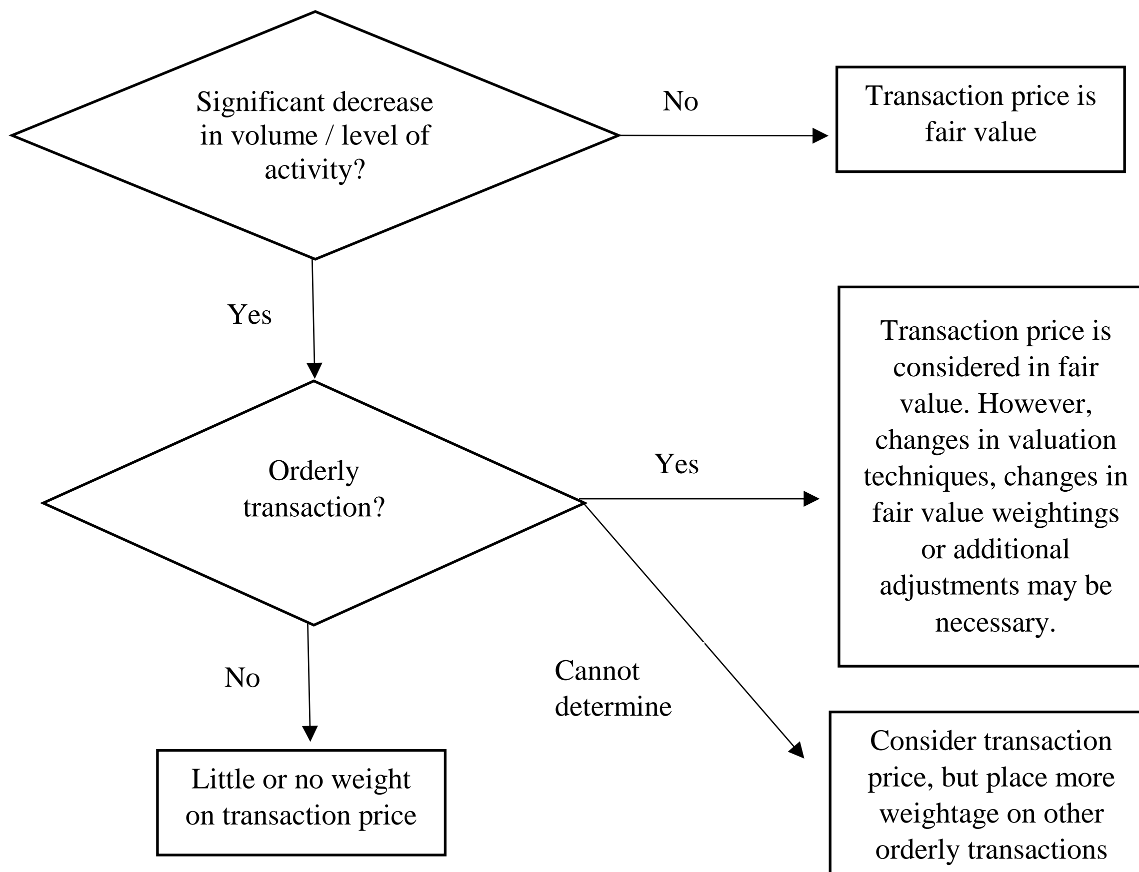
(c) The transaction is not orderly.

Where the decrease in volume/activity necessitates an adjustment, SLFRS 13 prescribes the requirements in terms Paragraph B39[(6)] and Paragraph B40[(7)] of SLFRS 13. According to the above provision, a change in valuation technique or the use of multiple valuation techniques

may be appropriate in such situations. When multiple techniques result in a wide range of fair values resulting further analysis may be required.

Recommendations:

Considerations in determining the level of reliance on market prices, assuming that the transaction price was fair value before the decline in activity are as follows:



As a result of the impossibility to fair value due to unavailability of reliable information or distress prices, an active market may not exist for respective equity instrument to measure the fair value of financial instruments at level I. The COVID-19 pandemic has significantly affected financial markets in the first quarter of 2020. Stock markets have declined sharply and volatility has increased. On the basis that there are still quoted prices in an active market or are still observable, the increase in such volatility shall not change the manner in which fair value is measured at the reporting date. Further, incorporating such increase in volatility into valuation models may pose challenges to entities. While volatility in the financial markets may suggest that the prices are aberrations and do not reflect fair value, it would not be appropriate for an entity to disregard market prices at the measurement date, unless those prices are from transactions that are not orderly. The concept of an orderly transaction is intended to distinguish a fair value measurement from the price in a distressed sale or forced liquidation.

Therefore, it is permitted to apply an appropriate valuation technique to measure the fair value of financial assets. However, such values calculated and used as the fair value in the financial statements for the period 2019/2020 by using different valuation techniques are not expected to exceed the market value reported as at 31st December 2019.

03. Impairment of Assets

Issue:

Impairment of assets, require an entity to assess, at the end of each reporting period, whether there is any indication that non-financial assets may be impaired. The impairment test only has to be carried out if there are such indications and need to estimate the recoverable amount of the asset. This assessment has become even more critical with the COVID 19 condition.

Analysis:

Measurement of recoverable amount involves certain level of estimates and judgment. Fair value less costs to sell depends on the fair value measurement and the value in use requires several estimates of the future expected cash flows. There are internal and external impairment indicators which an entity shall assess at the end. However, paragraph 10 of LKAS 36 states that irrespective of the indication, there shall be an annual impairment assessment for the intangible assets with an indefinite useful life or an intangible asset not yet available for use and goodwill acquired in a business combination. In terms of Paragraph 12 of LKAS 36, there are external and internal sources of information which provide an indication that the asset may be impaired. Further, paragraph 19 of LKAS 36 states that the entities may elect to measure the recoverable amount as the higher of the fair value less cost to sell or value in use and it is not always necessary to determine both provided that one of those exceeds the recoverable amount.

Changes in the fair value has an impact on the measurement of the impairment since fair value less cost to sell is one measurement used to measure the recoverable amount of any assets. Paragraphs 25 to 29 of LKAS 36 provides guidance on the measurement of Fair value less cost to sell. In addition, as per paragraph 6 of LKAS 36 value in use estimates the future cash flows expected to be derived from such asset's continuing use of the asset and from its ultimate disposal applying the appropriate discount rate to those future cash flows. Accordingly, measurement of value in use involves significant estimates which will be reflected in the computation also get impacted from this outbreak situation**.** Paragraph 30 of LKAS 36 provides certain elements that shall be reflected in the computation which include the following:

- Uncertain future cash flows
- Uncertain timing factor
- Fluctuating market interest rates due to the prevailing situation
- Uncertain time value of money
- Foreign exchange rate fluctuations.

- High judgmental application for the forecasting production, sales quantities.

In addition, para 134 (f) of LKAS 36 states that an entity needs to disclose reasonably possible changes in the key assumptions with the value assigned to those assumptions on which the management has determined its recoverable amount that would cause the carrying amount to exceed its recoverable amount.

Recommendation:

The current development in this pandemic may show evidence on the internal and external sources of impartment indicators. Decline of the stock market, decrease in interest rates, reduction in the market commodity prices, import and export barriers and lockdown situation of the economies are some of the external indications that provide evidence on the need to do an assessment for impairment. On the other hand, the idling of assets, non-moving stocks, non-operating properties and other manufacturing plants, less production and drop in the selling prices will create a need to test the impairment from the internal side. Even though the cost has not changed, there is a possibility of recoverable amount to come down since many of the organisations will result in significant drops in performance that would lead to reductions in the forecasts used in the value in use calculations. On the other hand fair value figures as at the reporting date would also be impacted. However, the impact of this particular circumstance could be considered as temporary trigger for impairment supported with the planned relief measures as well. In addition, the most of the non-financial assets would last for a longer term in the financial statements. Accordingly, this event alone won't provide impairment indications which require to assess the recoverable amount.

Since the measurement of the impairment will get highly impacted by this uncertain environment, it is necessary for the preparers to make adequate disclosures with the special attention on the application of estimates and the evidences, that the entity has based for these estimates and any significant assumptions made.

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, cash flow projections shall 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. (refer paragraph 33(a) of LKAS 36)
- In assessing the fair value, the estimates and assumptions used are from the perspective of market participants (paragraph 22 of SLFRS 13).

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. 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. It is important 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. (paragraphs A1, A16, A18 of LKAS 36)

In addition, an entity may also make detailed disclosures on the application of fair value measurement basis due to this situation and the probability usage of value in use under multiple scenarios and the key assumptions and judgments used for each scenario thereon. Accordingly, there is a need to provide detailed disclosures on the assumptions made relating to the long-term use and impact on assets, supported by sensitivity analyses. In addition, entities may need to do the forecasting under multiple scenarios to reflect the possible current and future economic situations than relying on a single estimate as the value-in-use measurement.

04. Going Concern

Issue:

Disruptions in the supply chain, logistics and other significant changes in demand can have implications for the working capital of an entity and resulting liquidity issues that affect the going concern in its operations. 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 which would cause significant doubt on the going concern of such entity.

Analysis:

Paragraph 25 of LKAS 1[(8)] *Presentation of Financial Statements* states that when preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. Further, in terms of paragraph 26 of LKAS 1, in assessing whether the going concern assumption is appropriate, management considers all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period.

Recommendation:

Management is required to assess the entity's ability to continue as a going concern. When making that assessment, management takes into consideration the existing and anticipated effects of the COVID 19 outbreak on the entity's business activities in its assessment of the appropriateness of the use of the going concern basis considering a period as far as possible that goes beyond 12 months. It is considered the COVID 19 condition is temporary. 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 temporarily suspended before

or after the reporting date, management would need to consider a wide range of factors relating to the current adverse situation including, expected impact on liquidity and profitability before it can satisfy itself that the going concern basis is appropriate. In the event, there are any plans to permanently curtail the business activities or go ahead with closure of business the going concern assumption may be inappropriate.

This assessment needs to be performed up to the date on which the financial statements are issued. When management assesses the entity's ability to continue as a going concern, it will need to consider the current economic uncertainty and market volatility caused by the COVID-19 outbreak. 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 entity's response to the impact of COVID-19 (paragraph 33 of SLFRS 7).

Examples of specific disclosures required include:

- an explanation of how the entity manages liquidity risk; and
- disclosures of defaults and breaches relating to the borrowings recognised during and at the end of the reporting period (paragraphs 18–19, 39(c) of SLFRS 7).

Accordingly, given the significance and widespread impact of COVID-19, expanded disclosures may be necessary in the financial statements.

Therefore, all available information shall be considered about the future, which could be obtained after the reporting date including measures taken by the government and banks to provide relief to affected entities in their assessment of going concern. In this context, following actions could be taken by the management:

- Update forecasts and sensitivities, as considered appropriate, considering the risk factors identified and the different possible outcomes. It is important to consider downside scenarios such as impact of lockdown when relevant.
- Review projected loan covenant compliance in different scenarios and therefore the related implications on availability of future funding.
- Assess its plans to mitigate events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. Management would be expected to reassess the availability of finance. The entity needs to assess whether its plans are achievable and realistic.

For example, for 31 December 2019 financial statements and beyond, the entities that are severely affected by COVID-19, even though the significant impact on operations occurred after the year end, it will be necessary for management to consider the appropriateness of preparing financial statements on a going concern basis.

It will be critical for management to assess the impact the current events and conditions will have on entity's operations and forecasted cash flows, with the key issue being whether an entity will have sufficient liquid cash flows to continue to meet its obligations as they fall due. The management should reassess the availability of finance because it may not be easily replaced, and the costs may be higher in the current circumstances of COVID 19 outbreak. 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 by changing in the going concern assumption is considered as an adjusting event.

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 used by management is subject to such material uncertainties. Additional disclosures will be needed, explaining the changes and how the company manages its liquidity in these difficult economic conditions.

The degree of consideration depends on the facts in each case. When an entity has a history of profitable operations and ready access to financial resources, such entity may reach a conclusion that the going concern basis of accounting is appropriate without detailed analysis. In other cases, management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate. 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 to the same 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 context.

05. Events After the Reporting Period

Issue:

It is to be noted that significant development and spread of the coronavirus did not take place in the country until January 2020 and as at 31 December 2019, only limited events and associated actions took place. There is a need to evaluate whether the consequences of COVID-19 represent subsequent events that need adjustments or disclosures in the financial statements at the reporting date.

Analysis:

Paragraph 3 of LKAS 10 defines the 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. Accordingly, two types of events can be identified and reflected in the financial statements as paragraphs 8 and 10:

(a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period) to be adjusted in the financial statements-; and
(b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period).

Further, as per paragraph 19, if an entity **receives information after the reporting period** about conditions that existed at the end of the reporting period, it shall **update disclosures** that relate to those conditions, in the light of the new information.

Paragraph 21 of LKAS 10 states that 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 nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made for each material category of non-adjusting event after the reporting period:

Recommendation:
For entities that are affected, or expect to be impacted by the outbreak or by the counter measures taken, judgement has to be exercised by the management on whether and, if so, what events will provide evidence of the conditions that existed at the end of the reporting period to indicate the impact on the entity's activities or its assets and or liabilities. When making this judgement, the entity needs to take into consideration all available information about the nature and the timeline of the COVID 19 outbreak and counter measures taken.

As per the analysis, if the management concludes that an event as a non-adjusting event, but the impact of it is material, the entity is required to disclose the nature of the event and an estimate of its financial effect. For example, qualitative and quantitative factors need to be evaluated on how the market volatility subsequent to the year-end has affected its equity investments and governmental measures imposed and border controls that have affected or may affect its operations. If such an estimate cannot be made reliably, then the entity is required to disclose that fact.

On this basis, the effects of the coronavirus could be concluded generally:

- as a 'non-adjusting event' for entities with annual reporting date as at 31 December 2019 and therefore forecasts, projections and associated assumptions used in preparing financial statements for the year ended 31 December 2019 which could have impacted either little or no change as a result of the coronavirus outbreak unless existence of a condition can be clearly demonstrated.
- for reporting periods ending thereafter (eg: for financial periods ending 31st March 2020**),** the effects and business implications caused due to the coronavirus condition is likely to be

incorporated into the financial statements as an adjusting event supported by adequate disclosures.

06. Recognition of Deferred Taxes

Issue:

COVID 19 could have impacted the entity's future profits and in turn impact the amount of deferred tax assets and liabilities that can be originated or recovered due to origination or reversal of deductible temporary differences.

Analysis:

According to paragraph 24 of LKAS 12 *Income Taxes,* a deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised. Paragraph 34 of LKAS 12 states that a deferred tax asset shall be recognised for the carried forward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised.

Recommendation:

It is important for an entity to assess the effect of the changes that may have to be made to the profit projections or future forecasts due to the business implications and probability of recoverability of deferred tax assets recognized based temporary differences. Further, there could be any impact on the plans not to distribute the profits of subsidiaries, which might require entity to reconsider recognition of any deferred tax liability in such circumstances. In addition, in the current circumstances, an entity's projections of future taxable profits may be affected by:

- changes in forecast cash flows – e.g. expected decrease in production or sales prices with the increase in costs;
- relief packages offered by the government / financial institutions
- changes in tax strategies of the entity; and
- substantively enacted changes to the income tax law introduced as part of a government's measures in response to COVID-19 – e.g. tax reliefs, additional tax deductions, a reduced tax rate etc

Some of these changes may reduce future taxable profits, while others may potentially increase them. In addition, some of the changes – e.g. government's measures in response to COVID-19 – may impact the timing of the reversal of temporary differences. When preparing projections of future taxable profits for the purposes of the deferred tax asset recognition test,

a company needs to reflect expectations at the reporting date and use assumptions that are consistent with those used for other recoverability assessments.

Disclaimer:

This financial reporting guidance note has been produced purely based on the available information as at the date of the issue of this document and the latest information become available are necessary to take in to consideration as and when necessary in exercising estimates and judgements.

References to SLFRSs

1. Paragraph 5.4.1 of SLFRS 9 states that the interest revenue shall be calculated by using the effective interest method (EIR). Interest revenue shall be calculated by using the effective interest method (EIR). This shall be calculated by **applying the effective interest rate to the gross carrying amount** of a financial asset except for:
   (a) *purchased or originated credit-impaired financial assets* where credit-adjusted effective interest rate has to be applied to the amortised cost from initial recognition.
   (b) financial assets that are not purchased or originated credit-impaired financial assets but subsequently have become credit-impaired financial assets where effective interest rate has to be applied to the amortised cost in subsequent reporting periods.

2. In terms of paragraph 5.4.2 of SLFRS 9, if an entity which has calculated interest revenue by applying the effective interest method to the amortised cost of SLFRS 9, if an entity which has calculated interest revenue by applying the effective interest method to the amortised cost in accordance with paragraph 5.4.1(b) shall calculate the interest revenue by applying the effective interest rate to the gross carrying amount in subsequent reporting periods, if the credit risk on such financial instrument improves so that the financial asset is no longer credit-impaired and the improvement can be related objectively to an event occurring after the requirements in paragraph 5.4.1(b) were applied.

3. *Paragraph 5.4.3 of SLFRS 9:*
   When the contractual cash flows of a financial asset are renegotiated or otherwise modified and the renegotiation or modification does not result in the derecognition of that financial asset in accordance with this Standard, an entity shall recalculate the gross carrying amount of the financial asset and shall recognise a modification gain or loss in profit or loss. The gross carrying amount of the financial asset shall be recalculated as the present value of the renegotiated or modified contractual cash flows that are discounted at the financial asset's original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets) or, when applicable, the revised effective interest rate calculated.

4. *Paragraph B5.5.27 of SLFRS 9:*

   sIf the contractual cash flows on a financial asset have been renegotiated or otherwise modified, but the financial asset is not derecognised, that financial asset is not automatically considered to have lower credit risk. **An entity shall assess whether there has been a significant increase in credit risk since initial recognition on the basis of all reasonable and supportable information that is available without undue cost or effort**. This includes historical and forward-looking information and an assessment of the credit risk over the expected life of the financial asset, which includes information about the circumstances that led to the modification. Evidence that the criteria for the recognition of lifetime expected credit losses are no longer met may include a history of up-to-date and timely payment performance against the modified contractual terms. Typically, a customer would need to demonstrate consistently good payment behaviour over a period of time before the credit risk is considered to have decreased.

5. *Paragraph B38 of SLFRS 13:*

   If an entity concludes that there has been a significant decrease in the volume or level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities), further analysis of the transactions or quoted prices is needed. A decrease in the volume or level of activity on its own may not indicate that a transaction price or quoted price does not represent fair value or that a transaction in that market is not orderly. However, if an entity determines that a transaction or quoted price does not represent fair value (eg there may be transactions that are not orderly), an adjustment to the transactions or quoted prices will be necessary if the entity uses those prices as a basis for measuring fair value and that adjustment may be significant to the fair value measurement in its entirety. Adjustments also may be necessary in other circumstances (eg when a price for a similar asset requires significant adjustment to make it comparable to the asset being measured or when the price is stale)’.

6. *Paragraph B39 of SLFRS 13:*

   This SLFRS does not prescribe a methodology for making significant adjustments to transactions or quoted prices. Paragraphs 61–66 and B5–B11 discuss on the use of valuation techniques when measuring fair value. Regardless of the valuation technique used, an entity shall include appropriate risk adjustments, including a risk premium reflecting the amount that market participants would demand as compensation for the uncertainty inherent in the cash flows of an asset or a liability (see paragraph B17). Otherwise, the measurement does not faithfully represent fair value. In some cases determining the appropriate risk adjustment might be difficult. However, the degree of difficulty alone is not a sufficient basis on which to exclude a risk adjustment. The risk adjustment shall be reflective of an orderly transaction between market participants at the measurement date under current market conditions’. Accordingly, appropriate risk adjustments should be included for the uncertainty inherent in the cash flows, even when such adjustments are difficult to determine.

7. *Paragraph B40 of SLFRS 13:*

If there has been a significant decrease in the volume or level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate (eg the use of a market approach and a present value technique). When weighting indications of fair value resulting from the use of multiple valuation techniques, an entity shall consider the reasonableness of the range of fair value measurements. The objective is to determine the point within the range that is most representative of fair value under current market conditions. A wide range of fair value measurements may be an indication that further analysis is needed.

8. *Paragraph 25 of LKAS 1:*

When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. When management is aware, in making its 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 entity shall disclose those uncertainties. Disclosure of significant judgement is also required where the assessment of the existence of a material uncertainty is a significant judgement. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.