

Need to know

Accounting considerations related to the Coronavirus 2019 disease for FRS 102 reporters

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Introduction

The Coronavirus 2019 (COVID-19) pandemic is affecting economic and financial markets with entities experiencing conditions often associated with a general economic downturn. These include, but are not limited to, financial market volatility and erosion, deteriorating credit, liquidity concerns, further increases in government intervention, increasing unemployment, broad declines in consumer discretionary spending, increasing inventory levels, reductions in production because of decreased demand, redundancies and furloughs, and other restructuring activities. The continuation of these circumstances could have a prolonged negative impact on an entity's financial results.

In its [Guidance for Companies on Corporate Governance and Reporting](#), the Financial Reporting Council (FRC) states that "COVID-19 is affecting all businesses and individuals but the critical implications for individual companies may differ, as will their plans to mitigate some of the effects, their capacity to follow these plans and the level of resources available to withstand the effects that remain. In setting out its principal risks and uncertainties, a company should consider the specific resources, assets and relationships that are most under threat and the steps being taken to protect them." The FRC notes that "Boards cannot predict the extent and duration of the COVID-19 pandemic nor its consequences for the global economy. It is however reasonable for investors to expect companies to be able to articulate their expectations of the possible impacts on their specific business in different scenarios. This makes the need for full disclosure of judgements, assumptions and sensitive estimates significantly more important than usual."

This **Need to know** discusses certain key FRS 102 accounting considerations related to conditions that may result from the COVID-19 pandemic. Small companies applying Section 1A of FRS 102 are subject to a more limited set of disclosure requirements. However, such companies are still required by law to ensure that their accounts give a true and fair view; additional disclosures in relation to the effects of COVID-19 may therefore be advisable. The significance of the individual issues discussed below will of course vary by industry and by entity, but we believe that the following topics will be the most pervasive and difficult to address.

For more information please see the following websites:

www.ukaccountingplus.co.uk

www.deloitte.co.uk

• **Preparation of forecast cash flow estimates**—The use of forecast information is pervasive in an entity's assessment of, among other things, the impairment of assets, impairment losses on financial assets, the recoverability of deferred tax assets and the entity's ability to continue as a going concern. Unique complexities associated with preparing forward-looking information as a result of the pandemic and economic downturn include the following:

- There is a wide range of possible outcomes, resulting in a particularly high degree of uncertainty about the ultimate trajectory of the pandemic and the path and time needed for a return to a “steady state”.
- The mid- and long-term economic impact of the pandemic is highly dependent on variables that are difficult to predict. Recently, the UK and many other governments have gradually unwound lockdown measures, but there is ongoing uncertainty about the future availability of support schemes, occurrence of regional or national lockdowns, and measures in response to potential future waves. Each entity will need to translate the possible effect of those macro conditions into estimates of its own future cash flows.

Nevertheless, entities will need to do their best to make reasonable estimates, prepare comprehensive documentation supporting the basis for such estimates and provide robust disclosure of the significant judgements exercised, the key assumptions used and, potentially, their sensitivity to change.

• **Recoverability and impairment of assets**—Perhaps the most acute example of the increased challenge associated with forecast information is the impairment testing for non-financial assets (for example, inventory, property, plant and equipment (PP&E), intangible assets and goodwill). The impairment tests for these assets often require the development of cash flow projections that are subject to the significant uncertainties noted above.

• **Accounting for financial assets**—There has been a severe decline in the fair value of many financial assets, particularly equity securities. The ability of debtors to comply with the terms of loans and similar instruments has also been adversely affected. Entities will need to carefully consider and apply the appropriate measurement and impairment loss recognition requirements set out in Section 11 and Section 12 of FRS 102.

• **Contract modifications**—Changes in the economic activity caused by the pandemic will cause many entities to renegotiate the terms of existing contracts and arrangements. Examples include contracts with customers, compensation arrangements with employees, leases and the terms of many financial assets and liabilities. Entities will need to ensure that the relevant requirements under FRS 102 are applied.

• **Events after the end of the reporting period**—It may be challenging for an entity to determine if an event after the end of the reporting period is adjusting or non-adjusting in a global marketplace that is highly volatile and in which major developments occur regularly (e.g. announcements of government stimuli and restrictions) and the stock market's reaction to new information. Although entities may not have all facts ‘on hand’ at the reporting date, once such facts are gathered an assessment must be based on conditions as they existed at the reporting date. The amounts in the financial statements must be adjusted only to reflect subsequent events that provide evidence of conditions that existed at the reporting date.

• **Going concern**—As a result of COVID-19 and its associated effects, entities need to consider whether, in their specific circumstances, they have the ability to continue as a going concern for at least, but not limited to, twelve months from the date the financial statements are authorised for issue. Management's assessment of the entity's ability to continue as a going concern involves making a judgement, at a particular point in time, about inherently uncertain future outcomes of events or conditions. This will require an entity to consider, among other things, (1) the extent of operational disruption; (2) potential diminished demand for products or services; (3) contractual obligations due or anticipated within one year; (4) potential liquidity and working capital shortfalls; and (5) access to existing sources of capital (e.g. available lines of credit, government aid). In making its going concern assessment, FRS 102 Section 32 Events after the Reporting Period requires an entity to consider events up to the date of authorisation of the financial statements.

Entities must carefully consider their unique circumstances and risk exposures when analysing how recent events may affect their financial statements. Specifically, financial statement disclosures will need to convey the material effects of the COVID-19 pandemic.

Material judgements and estimates

As a result of the uncertainty associated with the unprecedented nature of the COVID-19 pandemic, entities are likely to face challenges related to selecting appropriate assumptions and developing reliable estimates. Nevertheless, they will still be required under FRS 102 to develop estimates that underlie various accounting conclusions. To develop estimates, entities will need to consider all available information as well as whether they have met all applicable disclosure requirements, including those in FRS 102 Section 8 Notes to the Financial Statements.

A number of assumptions or estimates may be required for more than one purpose (e.g. forecast revenues may be relevant to impairment tests and recognition of deferred tax assets). Consistent assumptions should be used for all relevant assessments.

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

In its [thematic review](#) of the financial reporting effects of COVID-19, the FRC notes that it expects “sensitivity analysis or details of a range of possible outcomes to be provided for areas subject to significant estimation uncertainty. The number of disclosures in this area is likely to increase as a result of COVID-19.”

Depending on an entity's specific circumstances, each of the areas discussed in this publication may be a source of material judgement and uncertainty that requires disclosure applying Section 8. Where this is the case, the entity should provide disclosures, distinguishing between:

- significant judgements (disclosure required by FRS 102.8.6), i.e. judgements other than estimations made in applying an entity's accounting policies, often as to how an item is characterised; and
- significant sources of estimation uncertainty (disclosure required by FRS 102.8.7), if the source of estimation uncertainty results in a significant risk of material adjustment to assets or liabilities within the next financial year, i.e. assumptions or other sources of estimation uncertainty (including judgements involving estimation), primarily over the carrying amount of an item.

In the current situation, it would appear reasonable for entities not to be bound by a narrow interpretation of what constitutes a significant source of estimation uncertainty and provide as much context as possible for the assumptions and predictions underlying amounts recognised in the financial statements, in line with the spirit of the requirements of FRS 102.8.7. This is supported by the FRC's [guidance](#), which notes that relevant judgements and assumptions might include:

- the availability and extent of support through government support measures that have been announced;
- the availability, extent and timing of sources of cash, including compliance with banking covenants or reliance on those covenants being waived; and
- the duration of social distancing measures and their potential impacts.

There is not a single view on how the COVID-19 pandemic will evolve or its impact on the economy. This uncertainty makes the need for full disclosure of judgements, assumptions and sensitive estimates significantly more important than usual.

The disclosure provided about the key assumptions, including the sensitivity analysis based on a range of reasonably possible outcomes, should reflect the conditions at the reporting date. When key assumptions, or the range of reasonably possible changes to those assumptions, are affected significantly as a result of non-adjusting events after the reporting date, information about those changes, including an estimate of the financial effect, should be provided separately (see [Events after the end of the reporting period](#)).

A Deloitte [Need to know](#) publication provides more detail on the disclosure of significant judgements and sources of estimation uncertainty.

Going concern

COVID-19 is disrupting the operations of many businesses. Entities will need to consider whether such disruption will be prolonged and result in diminished demand for products or services or significant liquidity shortfalls (or both) that, among other things, cause management to assess whether the entity may be able to continue as a going concern for at least, but not limited to, twelve months from the date the financial statements are authorised for issue.

Financial statements are prepared on a going concern basis unless management intends either to liquidate the entity or to cease trading, or has no realistic alternative but to do so. When making its assessment, if management is aware 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 must disclose those uncertainties.

An entity's current facts and circumstances may challenge the going concern basis of preparation. Assessing whether an entity is a "going concern" typically requires the following factors to be considered:

- whether the forecast performance would result in an adequate level of headroom over the entity's available borrowing facilities and compliance with relevant loan covenants; and
- the availability of sufficient committed borrowing facilities for the foreseeable future and whether there are indicators that the lending counterparty will be unable to provide this funding.

In the current situation, the assessment is made more difficult given the uncertainties about the impact of the COVID-19 pandemic, the extent and duration of social distancing measures in effect in many jurisdictions and the impact on the economy. Management should consider the impact of these matters on the entity's specific circumstances, in particular current and potential cash resources including access to existing and new financing facilities, and factoring and reverse factoring arrangements. Access and use of such facilities and arrangements should be disclosed.

The assessment as to whether the going concern basis is appropriate takes into account events after the end of the reporting period. For example, 31 December 2019 reporters that are severely affected by COVID-19, even though the significant impact on operations occurred after year-end, will need to consider the appropriateness of preparing financial statements on a going concern basis.

In making this assessment, management will need to take into account all information available up to the date of authorisation of the financial statements. The information to be considered includes government announcements affecting the ability of an entity to operate and of any government assistance programmes to which the entity may be entitled. When management is aware of material uncertainties

that cast a significant doubt on the entity's ability to continue as a going concern, FRS 102.3.9 requires the entity to disclose those material uncertainties in the financial statements. The disclosure should be specific to the entity's own situation, for example explaining how and when the uncertainty may crystallise and its impact on the entity's resources, operations, liquidity and solvency. The assumptions used in determining whether an entity is a going concern should be compatible with the information used in other areas of the financial statements (e.g., liquidity risk management disclosure, impairment of non-financial assets, recognition of deferred tax assets, hedge accounting).

Given the current uncertainty and the variety of outcomes still possible related to the course of the pandemic and its adverse impact on economies all over the world, entities will need to consider a wide range of factors related to current and expected profitability, among other things. The FRC has highlighted that if management identify events or conditions (other than those with a remote probability of occurring) that could lead to corporate failure, these should be disclosed as material uncertainties. In identifying such events or conditions, management should consider both the uncertainty and the likely success of any realistic possible response to mitigate this uncertainty. There may be cases when an entity concludes, after having considered all relevant information, including the feasibility and effectiveness of planned mitigation, that there are no material uncertainties that cast significant doubt about its ability to continue as a going concern requiring disclosure under FRS 102.3.9.

However, in this current climate, reaching that conclusion will often involve significant judgements around the range of outcomes to consider and the probabilities assigned to those outcomes. Furthermore, the range of possible outcomes and their impact on the entity's future operations may be broad, meaning that assigning more or less weight to possible outcomes could make a difference in the entity's conclusion regarding the existence of material uncertainties.

FRS 102.8.6 requires disclosure of the judgements made that have the most significant impact on the amounts recognised in the financial statements. FRS 102.8.6 also requires disclosure of the significant judgements which the entity has made to reach the conclusion that no disclosure of material uncertainties is required under FRS 102.3.9, especially when other reasonable judgements may have resulted in a different conclusion. Such disclosure is important to provide users of the financial statements with sufficient information to understand the pressures on liquidity, viability and solvency.

The FRC's [thematic review of COVID-19 related financial reporting](#) and the FRC Lab report '[COVID-19 – Going concern, risk and viability](#)' both provide further guidance on what constitutes informative, helpful disclosure around going concern and contain examples of better practice.

Events after the end of the reporting period

Given the current economic environment and the likelihood that events may occur rapidly or unexpectedly, entities should carefully evaluate information that becomes available after the end of the reporting period but before the date of authorisation of the financial statements. The amounts in the financial statements must be adjusted to reflect events after the end of the reporting period that provide evidence of conditions that existed at the end of the reporting period. Events that are indicative of conditions that arose after the reporting period are non-adjusting events. They are not reflected in the recognition or measurement of items in the financial statements, but require disclosure when material.

Often the "events" are (1) company-specific; and (2) associated with a specific account that permits a more precise analysis. However, sometimes the "events" are macroeconomic in nature (such as those resulting from COVID-19) and have a pervasive impact on many estimates in a set of financial statements which may make it difficult to ascertain whether such conditions "existed" at the reporting date.

The full impact of the COVID-19 pandemic on medium- and long-term economic activity is still unknown, as is the future availability of support schemes, occurrence of regional or national lockdowns, and measures in response to potential future waves. However, COVID-19 will be a factor in an entity's analysis of estimates made in the preparation of the financial statements, including those related to impairments of trade debtors and other financial and non-financial assets, inventory obsolescence, variable and contingent consideration estimates, and other factors. Whilst the events stemming from COVID-19 are extremely volatile, entities will nevertheless be required to consider conditions as they existed at the reporting date when evaluating subsequent events.

With respect to reporting periods ending on or before 31 December 2019, it is generally appropriate to consider that the effects of the COVID-19 outbreak on an entity are the result of events that arose after the reporting date. This means that decisions made in response to the COVID-19 outbreak may require disclosure in these financial statements but would not affect the amounts recognised.

For subsequent reporting dates, entities will need to judge how much of the impact of COVID-19 should be considered to arise from non-adjusting events. This will be highly dependent on the reporting date, the specific circumstances of the entity's operations and the particular events under consideration. In other words, there is no universal 'flip' point at which entities should view all COVID-19 related impacts to be adjusting events. Instead, each event should be assessed to determine whether it provides evidence of conditions that existed at the end of the reporting period or whether it reflects a change in conditions after the reporting date. In its [thematic review](#), the FRC note that "it may be difficult to determine whether a post balance sheet event is an adjusting or a non-adjusting event. Determining, whether, or not, a particular fact or circumstance is an adjusting or non-adjusting post balance sheet event may require significant

judgement.” This may then also require disclosure as discussed in [Material Judgements and Estimates](#).

If non-adjusting events are material, an entity is required to disclose the nature of the event and an estimate of its financial effect. The estimate does not need to be precise. It is preferable to provide a range of estimated effects as an indication of impact to not providing any quantitative information at all. However, where the quantitative effect cannot be reasonably estimated, qualitative description should be provided, along with a statement that it is not possible to estimate the effect.

Statement of comprehensive income and income statement

FRS 102 5.9A requires that “[w]hen items included in total comprehensive income are material, an entity shall disclose their nature and amount separately, in the statement of comprehensive income (and in the income statement, if presented) or in the notes”. The impact of COVID-19 may give rise to material expense or income items for many entities, for example restructuring provisions and impairment losses related to non-financial assets. When it is practicable to identify specifically and quantify such discrete items, they should be disclosed separately either in the statement of comprehensive income or in the notes to the financial statements, with appropriate explanation of those amounts.

An entity should also consider the requirements in FRS 102.5.9 to present additional line items, headings or subtotals when such a presentation is relevant to an understanding of the entity’s financial performance. Unless adapting the formats as permitted by FRS 102.5.5B, companies will also need to ensure that all income and expenses are included within the relevant statutory format heading as set out in the Accounting Regulations (SI 2008/410) (or, where applicable, the Small Companies Accounting Regulations (SI 2008/409)).

In determining whether an item should be presented separately, or a heading or subtotal added, an entity should consider:

- the nature and magnitude of the costs; and
- the rationale for creating a new header or subtotal and its usefulness.

Caution should be used when excluding certain items from “operating profit” if such a subtotal is presented.

The impacts of COVID-19 are macroeconomic and affect all entities. Whilst the current environment may be unprecedented, it results from a series of events globally that are likely to have a wide range of potentially long-term consequences. As discussed above, some of the impacts will give rise to discrete losses or expenses, such as those related to impairment losses or restructuring plans. However, there may also be other impacts such as an overall decrease in entities’ profitability due to lower revenue and/or the continuance of salaries and other expenses while operations are closed or curtailed. Accordingly, the identification of the impacts of COVID-19 on an entity’s performance may be difficult without use of arbitrary assumptions. Further, it would not be appropriate to present results in FRS 102 financial statements as though the impacts of COVID-19 had not happened on the grounds that the issue was not present in the comparative period. In fact, such “pro forma” presentation would not comply with the requirements to present line items in profit or loss by function under format 1 in the Accounting Regulation, or by nature under format 2, or equivalent information if the option to adapt the formats is taken. Likewise, it would not be appropriate to consider that the presentation of costs should change due to the effects of COVID-19 (for instance depreciation in respect of factory or premises that are closed for a period of time due to government measures). Any additional information that entities seek to include to explain the impact of COVID-19 should instead be included in the notes to the financial statements. However, consideration should be given to regulatory and other requirements related to the provision of alternative or non-GAAP measures (see [Alternative performance measures](#)).

Some entities present a three-column income statement or use other presentations to show ‘underlying’ results. Practices vary, but often such adjustments are made to facilitate the year-on-year assessment of results, or because they are not seen as forming part of the underlying activities of the entity or, in the opinion of management, their separate presentation enhances understanding of the financial performance of the entity and its businesses. Many of the effects of COVID-19 on an entity are likely to form part of the entity’s normal activities and thus should be considered to form part of the underlying business performance and should not be excluded from ‘underlying’ results presented in the income statement.

Alternative performance measures

Because of the significant impact of COVID-19 on their performance and financial position, entities may consider providing new alternative performance measures (APMs) or adjusting existing APMs.

In June 2015 the European Securities and Markets Authority (ESMA) published ‘Guidelines on Alternative Performance Measures’ (the ‘ESMA Guidelines’). Although these are described as “guidelines”, in actual fact this document establishes a series of rules regarding the presentation of APMs. In relation to UK annual reports and interim reports, the FRC has published [‘ESMA Guidelines on Alternative Performance Measures: Frequently Asked Questions’](#), which confirms that they will consider the Guidelines when reviewing company reports and accounts in assessing whether they are fair, balanced and comprehensive. While most FRS 102 reporters will not fall within the scope of the ESMA Guidelines, they may still be taken into consideration when preparing the annual report. Additionally, as explained in the previous section, under FRS 102 it is necessary to ensure that all income and expenses are included within the relevant statutory format heading. The presentation of any APMs should be consistent with this requirement. Although the ESMA Guidelines specifically exclude information presented in the financial statements from their scope, the FRC often applies similar principles in assessing the

appropriateness of information about APMs that is given in the financial statements themselves.

The FRC's [COVID-19 guidance](#) states that "APMs which attempt to provide a measure of 'normalised' or 'pro-forma' results, excluding the estimated effect of the COVID-19 crisis, are likely to be highly subjective and, therefore, potentially unreliable. In addition to the subjectivity arising around which costs to exclude, in most cases COVID-19 is likely to have resulted in reductions in revenues. Any adjustment for lost revenues would be hypothetical and could not be reflected reliably in an APM. We do not expect companies to provide these measures; for example, by including them in a 'third-column' income statement presentation."

In April 2020, ESMA issued a [new Q&A](#) (Q&A 18) which explains considerations an entity should make before publishing new and/or modified APMs to present the impact of COVID-19.

In particular, ESMA notes that:

- The definition and calculation of an APM should be consistent over time. Therefore, caution should be used when making adjustments to APMs currently used and/or when including new APMs solely to depict the impacts that COVID-19 may have on an entity's performance and cash flows.
- New/adjusted APMs must provide a fair review of the development, performance and financial position of the entity. Conversely, they must not provide an incorrect depiction of the entity's performance.
- An entity should carefully assess whether the intended adjustments or new APMs would provide transparent and useful information to the market, improve comparability, reliability and/or comprehensibility of APMs and of the financial information disclosed to the market.
- An entity should explain why it believes that an APM provides useful, reliable and relevant information regarding its financial position, cash flows or financial performance as well as the purposes for which it decided to use a specific APM and/or to modify a previously used APM.
- It may not be appropriate to include new/adjusted APMs when COVID-19 has a pervasive effect on the entity's overall financial performance, position, and/or cash flows. This is because, in such circumstances, these new/adjusted APMs may not provide reliable and more useful information to the market. Instead, the new/adjusted APMs may mislead users' understanding of the true and fair view of the entity's assets, liabilities, financial position and profit or loss.

Significantly, rather than adjusting existing APMs or including new APMs, ESMA urges entities to improve their disclosure and include narrative information to explain:

- how COVID-19 has impacted and/or is expected to impact their operations and performance;
- the level of uncertainty and the measures adopted or expected to be adopted to address the COVID-19 outbreak; and
- where applicable, details on how the specific circumstances relating to COVID-19 have affected the assumptions and estimates used in the determination of inputs to APMs, for example impairment losses, expected lease payment reductions or grants received.

Finally, both the FRC and ESMA remind entities that APMs should not be displayed with more prominence than measures directly stemming from financial statements.

Impairment of non-financial assets

General considerations

Entities will need to assess whether the impact of COVID-19 has potentially led to an asset impairment. Financial performance, including estimates of future cash flows and earnings, may be significantly affected by the direct or indirect impacts of recent and ongoing events.

FRS 102 Section 27 Impairment of Assets aims to ensure that an entity's assets are carried at not more than their recoverable amount

(i.e. the higher of fair value less costs to sell and value in use). Section 27 does not require an entity to monitor assets constantly (including goodwill) for indicators of impairment. Instead, FRS 102.27.7 requires entities to assess, at the end of each reporting period, whether there is any indication that assets may be impaired and, if such an indication exists, to perform an impairment test. The test is conducted for a 'cash-generating unit' (CGU) when an asset does not generate cash inflows that are largely independent of those from other assets. The CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

The scope of assets subject to the requirements in Section 27 is broad. It includes inventories, property, plant and equipment (carried at cost or revalued amount), intangible assets (carried at cost or revalued amount), goodwill, investment property carried at cost, biological assets carried at cost and investments in associates and joint ventures accounted for using the equity method. In an entity's separate financial statements, investments in subsidiaries, associates and joint ventures are also subject to the requirements of Section 27.

Indicators of impairment include (but are not limited to) significant changes with an adverse effect on the entity that have taken place during the period, or will take place in the near future in the market or economic environment in which the entity operates. An entity will also need to consider the extent to which, or the manner in which, an asset is used or is expected to be used (for example, an asset

becoming idle, plans to discontinue or restructure the operation to which an asset belongs or plans to dispose of an asset before the previously expected date). Section 27 also identifies the carrying amount of net assets exceeding the estimated fair value of an entity as an indicator of impairment.

Factors resulting from the COVID-19 pandemic which indicate that the carrying amount of a CGU may not be recoverable may include (1) decreased demand for the entity's products or service; (2) increased costs/business interruptions due to supply chain issues; (3) cancellations or postponements of orders by customers; (4) need to provide significant concessions to customers; (5) significant customers experiencing financial difficulties or cash flow difficulties. These factors may indicate that the entity may be forced to liquidate some of its assets rapidly.

Entities often rely on discounted cash flows in estimating recoverable amounts. Careful consideration of the cash flow projections, growth rate(s) and discount rate(s) will be critical in terms of the supportability and reasonableness of the calculations given the current market conditions. In particular, the projected cash flows should be based on what could have reasonably been known at the reporting date of the conditions that existed at that date. However, in a value in use calculation, they should not reflect the effects of restructuring plans that are not committed at the reporting date as this would be inconsistent with the requirement to determine the value in use of the CGU in its current condition at the end of the reporting period. Similarly, the benefits of government assistance should be reflected as cash inflows only if there is sufficient understanding of the government assistance programme at the reporting date, so that reasonable and supportable estimates can be developed regarding the amounts to which the entity is expected to be entitled. Depending on the range of possible outcomes for these expected government programmes, it may be more appropriate to use multiple scenarios and a probability-weighted expected value approach to arrive at management's best estimate of future cash flows and recoverable amount, as discussed further below. Factoring in uncertainties about future cash flows in an impairment analysis will require significant judgement. The assumptions made and the probabilities assigned to cash inflows associated with expected government assistance and whether and to what extent the entity will be eligible must be reasonable and supportable based on publicly available information at the reporting date and relevant information obtained after that date that reflects adjusting post balance sheet events as defined in FRS 102 Section 32.

The discount rate to be used should be a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the asset for which future cash flows have not been adjusted. Hence, to the extent that risk and uncertainties about the future impact of the COVID-19 pandemic are not reflected in the projected cash flows of the CGU being tested, they should be reflected in the discount rate applied.

In these uncertain times, management may face significant challenges in preparing the budgets and forecasts necessary to estimate the recoverable amount of an asset (or CGU). Management may determine that using an expected cash flow approach is the most effective means of reflecting the uncertainties of the COVID-19 pandemic in its estimates of recoverable amount. This approach reflects all expectations about possible cash flows instead of a single expected outcome. For example, a cash flow might be £100, £200 or £300, with probabilities of 10 per cent, 60 per cent and 30 per cent, respectively, giving an expected cash flow of £220, i.e. $(£100 \times 10\%) + (£200 \times 60\%) + (£300 \times 30\%)$. While an expected cash flow approach is highly dependent on assigning probabilities to estimates of future cash flows, such judgements on the inputs may nevertheless be more transparent and more readily tied to underlying commercial expectations than the addition of a 'COVID-19 risk premium' to the discount rate, which may be more arbitrary and for which there is no evidential base to support the quantum of the adjustment

Key principles to bear in mind are:

- Estimated cash flows should reflect a range of possible outcomes, rather than a single expected outcome.
- Cash flow projections may reflect the conditions in existence at the reporting date and be based on the most recent financial budgets/forecasts, approved by management at the appropriate level of authority. In these uncertain times, reliable detailed budgets may only be available for a short period.
- Projections of cash flows beyond the period covered by the most recent budgets/forecasts should be estimated by extrapolating the projections based on the budgets/forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified based on objective information about patterns over a product or industry lifecycle. This growth rate should not be overly optimistic and should not exceed the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market in which the asset is used, unless a higher rate can be justified. In some cases, it may be appropriate for the growth rate to be zero or negative.
- Future cash flows should be estimated for the asset in its current condition and should not include estimated future cash inflows or outflows expected to arise from improving or enhancing the asset's performance or future restructuring to which the entity is not yet committed (when the recoverable amount is determined as the value in use).
- The entity's weighted average cost of capital (WACC) may be used as a starting point for estimating a market discount rate, but this should then be adjusted to reflect the way the market would assess the cash-generating unit's cash flows (unless that risk is already included in the estimated cash flows). When considering the underlying individual inputs into a traditional capital asset pricing model ("CAPM"), consideration must be given to the interplay between inputs (i.e. the risk free rate assumption and the equity risk premium) and how the changes in some inputs may be offset by the change in other inputs. The expectation of a falling risk free rate environment

does not necessarily translate into a lower cost of capital.

- Care should be taken as to consistency of the data being prepared and compared to avoid double counting or omission of some data.

If information is received after the end of the reporting period, but before the financial statements are authorised for issue which indicates that an asset is impaired, management should consider whether that information is indicative of conditions that existed at the end of the reporting period. If so, an impairment review should be carried out. If the information received after the reporting period is not indicative of conditions existing at the end of the reporting period, it should not trigger an impairment test. Rather, the information should be disclosed as a non-adjusting event after the reporting period when it is of such importance that non-disclosure would affect decisions of users of the financial statements.

If there is an indication that the asset may be impaired, the underlying facts should be kept in mind when performing the annual reviews of the useful life of the asset, the depreciation or amortisation method used and the estimated residual value. These items may need to be adjusted even if no impairment loss is recognised.

Information about asset impairments will be critical in helping users of the financial statements understand the impact of the COVID-19 pandemic on an entity's financial performance and position. Disclosure of the key assumptions used to determine the recoverable amount, together with a description of management's approach to determining the value assigned to each key assumption, must be provided in sufficient detail. These include assumptions about the duration and intensity of effects of the suspension of activities and of the recovery phase. Key assumptions used in performing impairment tests are likely to represent a source of significant estimation uncertainty and therefore the information required by Section 27 of FRS 102 may need to be supplemented by the information required by Section 8, such as a sensitivity analysis

Valuation of inventories

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

FRS 102 Section 27 Impairment of Assets states that at each reporting date, entities should assess whether any inventories are impaired by comparing the carrying amount of inventories with the estimated selling price less costs to complete and sell. As a result of the pandemic, the realisable value of an item of inventory may fall below its cost for many reasons, including a decline in selling prices (e.g. as a result of price concessions offered to customers), or an increase in the estimate of costs to complete and market the inventories (e.g. increased costs to provide protection to employees). In a difficult economic environment, this comparison may be more challenging and require more detailed methods or assumptions. Interim inventory impairment losses should be reflected in the interim period in which they occur, with subsequent recoveries recognised as gains in future periods.

In addition, manufacturing entities may have to reassess their practices for fixed overhead cost absorption if production volumes become abnormally low during the year as a result of plant closures or lower demand for their products. FRS 102 Section 13 Inventories requires that variable production overhead costs should be allocated to each unit of production based on the actual use of the production facilities. It also calls for the allocation of fixed overhead costs to each unit of production based on the normal capacity of the production facilities.

The COVID-19 pandemic may affect manufacturing entities in a number of ways (e.g. shortages of labour and materials, or unplanned factory downtime) that, if sustained, may result in an abnormal reduction of an entity's production levels. In such circumstances, an entity should not increase the amount of fixed overhead costs allocated to each inventory item. Rather, the unallocated fixed overhead costs are recognised in profit or loss in the period in which they are incurred. These costs should typically be included as part of cost of sales. Conversely, if an entity produces goods that are in high demand as a result of the pandemic (e.g. personal protection equipment), its production levels may be abnormally high. If this is the case, the entity will need to decrease the amount of fixed overhead allocated to each inventory item.

An entity will also need to consider whether certain costs incurred because of the pandemic can be capitalised. These may include additional storage costs due to delays in delivery of inventories or costs of repackaging to make goods available in a different market with higher demand. FRS 102.13.13 gives the following as examples of costs that should be excluded from the cost of inventories and recognised as expenses in the period in which they are incurred:

- Abnormal amounts of wasted materials, labour, or other production costs.
- Storage costs, unless those costs are necessary in the production process before a further production stage.

- Administrative overheads that do not contribute to bringing inventories to their present location and condition.
- Selling costs.

Costs to secure or fulfil a revenue contract

In accordance with FRS 102 Section 23 Revenue, when recognising revenue by reference to the stage of completion, an entity may have recognised costs that relate to future activity on the transaction or contract, such as for materials or prepayments, as an asset. Entities will need to assess whether these costs are still recoverable; if a cost is incurred and recovery under the contract is not probable, it should be expensed immediately.

Under Section 23, entities can also recognise costs incurred in securing a construction contract as an asset if it is probable that a contract will be obtained. If pre-contract costs have been capitalised, and it subsequently transpires that it is no longer considered probable that the contract will be obtained, the costs should be recognised in profit or loss immediately. Entities may need to assess whether the COVID-19 pandemic has impacted the probability of obtaining such contracts.

Further, an entity should evaluate contract assets for impairment by using the same model as for trade receivables. See [Impairment of Financial Instruments](#) for more information.

Financial instruments

FRS 102 allows an entity to apply the recognition and measurement provisions of IAS 39 or IFRS 9 in place of those in FRS 102 Sections 11 and 12. Where an entity has made the choice to apply the provisions of IFRS 9, guidance can be found in the Need to Know for IFRS reporters

Impairment of financial instruments

COVID-19 can affect the ability of borrowers, whether corporate or individuals, to meet their obligations under loan relationships.

Individual and corporate borrowers may have a particular exposure to the economic impacts in their geography and industry sector. More broadly, reductions in forecasts in economic growth increase the incidence of default across many borrowers and impairments may increase due to the fall in value of collateral, evident more generally by falls in prices of assets.

Unlike in IFRS 9, where an expected credit loss model is used in measuring impairment of financial instruments, FRS 102 and IAS 39 feature an incurred loss model which requires that an entity assesses whether there is any objective evidence of impairment of any financial assets that are measured at cost or amortised cost at the end of the reporting period. An asset is impaired, and an impairment loss recognised, if and only if, the loss is incurred at the reporting date as a result of one or more events that occurred after initial recognition of the asset (a 'loss event'). If there is objective evidence of impairment, the entity is required to recognise an impairment loss in profit or loss immediately.

Such evidence may be debtor-specific, such as their particular financial difficulties, breaches of contract, delinquencies in payment, or the granting to them of a concession. Where not identified with respect to specific debtors, a loss event may still be identified from observable data indicating that there has been a measurable decrease in the estimated future cash flows from a group of debtors such as adverse national or local economic conditions or adverse changes in industry conditions.

For instruments measured at amortised cost, an impairment is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. For instruments held at cost less impairment (such as a loan commitment that cannot be settled net in cash and will result in the recognition of a basic financial instrument; or an investment in a subsidiary), an impairment is measured as the difference between the asset's carrying amount and the best estimate of the amount for which the asset could be sold at the reporting date. This difference is recognised in profit or loss for both.

Both of these approaches require the use of judgement and, as with impairment of non-financial assets, management should ensure that the financial statements include sufficient disclosure of the key assumptions used to determine the impairment loss recognised.

Consideration will also need to be given to when information and evidence of any loss event would have been available to the reporting entity, in line with the guidance above on [Events after the reporting period](#).

Fair value measurement

Where financial instruments are measured at fair value, management should ensure that the inputs to the valuation technique reflect market conditions on the measurement date and represent the market's assessment of the return required for an asset or liability of similar risk to that which is being measured. Observable market data cannot be ignored even if depressed prices are considered

temporary. Entities will need to pay particular attention to fair value measurements based on entity determined inputs and ensure that these unobservable inputs are used reflect how market participants would reflect the effect of COVID-19, if any, in their expectations of future cash flows, discount rates and other significant valuation inputs related to the asset or liability at the reporting date.

Liquidity risk management

Disruptions in production and reduced sales can have implications on an entity's working capital and could lead to a breach of a debt covenant resulting in a liability becoming current.

Entities may look for ways to manage this risk, including the use of alternative sources of funding, such as later payment to suppliers and arrangements with financial institutions such as supplier finance and reverse factoring which may permit the entity to draw down on finance in exchange for the financial institution paying the entity's suppliers. When entities have previously determined that liabilities to banks in these scenarios are presented as trade or other creditors rather than as borrowings, any increase in the repayment term will require a reassessment of the classification to ensure it remains appropriate. Disclosure of these facilities will be critical particularly when they are material to the entity's funding or viability.

Entities may also seek to obtain early settlement of their trade receivables via a financial institution buying the receivables at a discounted amount to the invoice amount. Such transactions should be carefully assessed to determine if derecognition of the factored receivables is appropriate.

Entities applying the recognition and measurement provisions of IAS 39 or IFRS 9 under FRS 102 are required to comply with the disclosure requirements of FRS 102 and not IFRS 7. Entities subject to the disclosure requirements of FRS 102.11.48A (financial instruments at fair value through profit or loss) or FRS 102.34.17 (financial institutions) should consider how the use of working capital enhancement or management techniques is reflected in the entity's disclosure of its liquidity risk management. The FRC's [thematic review into the financial reporting effects of COVID-19](#) indicates that the FRC expects entities to provide sufficiently detailed quantitative and qualitative disclosures about:

- their access to cash and sources of finance (including reverse factoring arrangements);
- any changes or likely changes to the existing financing arrangements;
- any new arrangements entered into;
- credit grading and any changes, which impact cost or access to funding (e.g. if the grading falls below investment grade); and
- any developments subsequent to the reporting date.

If relevant, the FRC expects entities to explain the impact of government assistance programmes as part of their liquidity risk management. For example, disclosures may include how much funding is available, the likelihood that the funding will be utilised and the time horizon over which the funds are available.

Entities should also consider the specific disclosure requirements for transfers of financial assets as required by FRS 102.11.45 when financial assets are transferred but derecognition criteria are not met, which may arise in the context of the use of debt factoring. Conversely, when supplier finance and reverse factoring arrangements are used, disclosures should be included to explain how accounting policies and judgements are applied in determining the balance sheet and cash flow statement presentation of amounts due and paid.

Where there has been a breach of covenant or default on a loan payable during the reporting period, entities will need to ensure that this is appropriately disclosed in line with FRS 102.11.47.

Entities may also need to reconsider the existing classification of certain investments as cash equivalents under FRS 102 Section 7 Statement of Cash Flows. To be classified as a cash equivalent, an investment – for example in a money market fund – must be highly liquid and readily convertible to known amounts of cash, and subject to insignificant risk of changes in value. Current economic conditions are likely to increase the volatility in prices of many investments and reduce their liquidity.

Classification of financial instruments

Under FRS 102, debt instruments that do not meet the conditions detailed in FRS 102.11.9 or FRS 102.11.9A are classified as *non-basic financial instruments*. Section 11 Basic Financial Instruments only requires re-assessment of the classification of a financial instrument if there has been a modification to contractual terms that are relevant to an assessment of classification.

Unlike IFRS 9, the classification of a financial asset under FRS 102 is unaffected by the entity's business model and is driven principally by the instrument's contractual terms. Due to the impact of COVID-19, terms of financial instruments may be renegotiated and modified. If the modification of the contractual terms result in derecognition of the original instrument and the recognition of a new instrument, the

classification of the new instrument is assessed at the point of its initial recognition. If the modification does not result in derecognition, and/or the introduction of a non-basic feature into an otherwise basic debt instrument does not result in derecognition of the original instrument, it would be considered a modification of contractual terms that is relevant to an assessment of the classification and so reassessment would be required.

For entities applying IAS 39, the modification of the contractual terms of a financial asset or a financial liability could result in the addition of a term that results in the need to assess under IFRIC 9 *Reassessment of Embedded Derivatives* whether there is an embedded derivative that should be separated from the modified contract. Modifications could also impact the classification of an entity's financial assets. For example modifications might result in an asset that previously qualified as "Loans and Receivables" no longer having terms that result in "fixed and determinable payments"; or the disposal of financial assets in response to COVID-19 may result in the need to consider whether that activity taints any "Held to Maturity" financial asset classifications under IAS 39:9.

Debt modifications and derecognition of financial liabilities

In applying Section 11 or IAS 39, a financial liability should be derecognised only when the obligation is discharged, cancelled or when it expires. An entity discharges its obligation by paying amounts of cash, other financial assets, or by delivering other goods or services to the counterparty. An obligation may expire due to the passage of time (for example, an unexercised written option). An obligation is cancelled when, through the process of law, or via negotiation with a creditor, an entity is released from its primary obligation to pay the creditor. However, if an entity seeks to renegotiate a debt instrument, the original liability must be derecognised and a new liability recognised if the terms of the new or modified liability are substantially different from those of the original.

In response to liquidity challenges posed by COVID-19, a reporting entity may seek to renegotiate terms of its borrowings or other liabilities resulting in amendments to existing agreements (either amendments to the cash flows or related covenants). In such cases, the entity must consider whether the modifications are substantial and would lead to derecognition. In some cases, a simple qualitative assessment will be sufficient to establish whether the terms of a new or modified liability are substantially different from those of the original one. When it is unclear, on the basis of a simple qualitative assessment, whether or not there has been a substantial modification an entity may use quantitative analysis to assess the impact of the modification. Such an analysis may consist of a comparison of the net present value of the cash flows under the new or modified liability to the net present value of the original liability, discounted at the original effective interest rate. In the absence of any guidance on the performance of a quantitative assessment, an entity should choose a reasonable approach as an accounting policy and apply it consistently to all financial liability derecognition assessments.

When a modification is substantial the existing financial liability is derecognised and the new liability is recognised at fair value resulting in a gain or loss. It is particularly important to note, however, that an adjustment to the carrying value will result even when the modification is not substantial (determined by discounting the revised cash flows at the original EIR).

When intragroup funding arrangements are modified, consideration should be given to the identification of intragroup capital contributions or distributions. Entities should determine whether there has been an impairment of a financial asset in advance of its modification. Thereafter, the difference between the carrying amount of the financial instrument derecognised and the fair value of the new financial instrument recognised may need to be allocated between a derecognition gain or loss and a capital contribution or distribution between parties under common control.

Changes in estimated cash flows

COVID-19 may result in a change in expectations regarding the exercise of prepayment, extension or conversion features in debt agreements. When a financial instrument is measured at fair value through profit or loss (FVTPL), changes in the likelihood of those features being exercised will be reflected in the fair valuation. When such features do not prevent the instrument being accounted for as a basic financial instrument and so are accounted for as part of the amortised cost of the debt instrument, changes in estimates of payments or receipts will result in remeasurement adjustments recognised in profit or loss in accordance with FRS 102.11.20 or IAS 39:AG8 as the revised expected cash flows are discounted at the instrument's original effective interest rate.

Hedge accounting

When a transaction has been designated as the hedged item in a cash flow hedge relationship under FRS 102 or IAS 39 the entity will need to consider whether the transaction is still a "highly probable forecast transaction" and if not, whether it is still expected to occur. Hedged items in a cash flow hedge that could be affected due to COVID-19 include:

- sale or purchase volumes that fall below the levels originally forecast;
- planned debt issuances that are delayed or cancelled such that interest payments fall below levels originally forecast; and
- business acquisitions or disposals that are delayed or cancelled.

If an entity determines that a forecast transaction is no longer highly probable, but still expected to occur, the entity must discontinue hedge accounting prospectively and defer the gain or loss on the hedging instrument that has been recognised in other comprehensive income accumulated in equity until the forecast transaction occurs. If the forecast transaction is no longer expected to occur the entity

must immediately reclassify to profit or loss any accumulated gain or loss on the hedging instrument.

When the expected timing of a designated hedged transaction changes, an entity is required to reassess whether the hedged transaction identified in the entity's hedge documentation is still the same hedged transaction (i.e. assess whether the hedged transaction is still expected to occur).

A change in the timing of a hedged forecast transaction when its occurrence remains highly probable may also have an effect on profit or loss. Hedge ineffectiveness can exist because a difference arises between the amount and/or timing of the hedged item and the hedging instrument. It is common for entities to determine a 'hypothetical derivative' to reflect the timing and amount of the hedged item and use the fair valuation of this to compare with the hedging instrument to determine the amount of hedge ineffectiveness to be recognised in profit or loss. As the timing and/or amount of the hedged item changes in response to economic conditions, entities should redefine the hypothetical derivative to ensure hedge ineffectiveness is appropriately recognised.

Contracts to buy or sell commodities

Section 12 of FRS 102, and IAS 39 deal primarily with contracts that are financial items; however, they also capture some contracts to buy or sell non-financial items. Contracts to buy or sell non-financial items that can be settled net (either in cash or by exchanging financial instruments) are within the scope of Section 12 or IAS 39 unless they were entered into, and continue to be held, for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements (i.e. are held for 'own use').

The significant disruption to supply and demand may result in net cash settlement of contracts to buy or sell commodities or other non-financial assets that were previously expected to be physically settled and were accounted for as 'own use' contracts (i.e. outside the scope of Section 12 or IAS 39). The assessment of whether a non-financial contract is held for 'own use' is a continuous assessment and is not only performed at inception of the contract. Consequently, the expected net cash settlement of contracts to buy or sell non-financial items (e.g. commodities) will bring those contracts within the scope of Section 12 or IAS 39 and result in classification of the contracts as financial assets or liabilities subject to the measurement requirements of that Standard. Under both Section 12 and IAS 39, commodity derivatives not designated in hedging relationships are accounted for at FVTPL.

When assessing whether contracts to buy or sell commodities are for own use, it will be necessary to identify the contract to which the assessment applies. Each contract must be evaluated in its entirety. For example, an entity may have a contract for 100 units, but its expected usage requirement is only 80 units. The entity intends to net settle the part of the contract it does not need in its normal course of business. Such partial net settlement can be achieved in different ways (e.g. by entering into an offsetting contract for 20 units, or by taking delivery of all 100 units and selling 20 immediately). The entire contract falls within the scope of Section 12 or IAS 39 because the entire contract cannot be argued to be in accordance with the entity's expected usage requirements.

Net settlement of a non-financial contract would only cause other similar contracts to fail the own use requirements if it establishes a past practice of net settlement. It is a matter of judgement as to what is past practice of net settlement. An entity will need to consider its historical behaviour, the reasons for past net settlement, and the relative frequency. Depending on the specific circumstances, it may be argued that an occurrence of a net settlement in the past was the result of an isolated non-recurring event that could not have been reasonably anticipated.

Entities sometimes enter into contracts where cash is prepaid for the supply of non-financial items, e.g. for commodities such as oil. For the payer of the prepayment, this may result in the recognition of a non-financial asset because it expects to receive the non-financial item and it meets the own use requirements in FRS 102.12.5. or IAS 39.5. Likewise, the recipient of the cash may recognise an obligation because it expects to deliver the non-financial item and it meets the own use requirements in Section 12 or IAS 39. The significant disruption to supply and demand may result in net cash settlement of contracts to buy or sell commodities or other non-financial assets that were previously expected to be physically settled and were accounted for as own use contracts. Expected net cash settlement of such contracts would result in the own use exception ceasing to apply for either party, meaning that the contract would be within the scope of Section 12 of FRS 102 (or IAS 39) and should be measured at fair value through profit or loss

Revenue

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

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

Existence of a contract

Under FRS 102, it is not appropriate to recognise revenue before a contract exists. In certain circumstances, as a consequence of the pandemic, the parties may not be able to approve a contract under an entity's normal and customary business practices. For example, the entity may not be able to obtain the signatures it normally obtains when entering into a contract because personnel from the entity or customer are unavailable or otherwise unable to provide signatures. Therefore, it is important to carefully evaluate whether the approval process creates a contract between the entity and its customer. In making this determination, an entity may consider consulting with its legal counsel.

The effect of a "force majeure" clause allowing the parties to terminate a contract without incurring penalties in certain extraordinary circumstances will also need to be considered

Contract modification

Although FRS 102 does not provide any specific provision or guidance for the treatment of contract modifications, Section 10 provides guidance when encountering a transaction, event, or condition not directly addressed by the Standard. This guidance permits making reference to EU-adopted IFRS. Entities therefore may consider analogising to the requirements of IFRS 15 in these situations. The Need to Know for IFRS reporters includes further guidance.

Measurement of revenue

Section 23 Revenue requires that an entity measures revenue at the fair value of consideration received or receivable. This measurement should take into account any discounts and rebates offered by the entity. For revenue from a service transaction or a construction contract that is recognised by reference to the stage of completion, Section 23 also requires that an entity must review and, if necessary, revise the estimates of revenue and costs throughout the progress of the transaction or contract. In doing so, the entity may need to consider any expected changes in (1) its ability to perform; and (2) customer behaviour that results from deteriorating economic conditions. For example, an entity may need to consider updating its estimated revenues if it expects an increase in product returns, decreased usage of its goods or services or decreased royalties, increased invocation of retrospective price protection clauses, changes in redemption rates of coupons or volume rebates, or potential payment of contractual penalties or liquidating damages associated with its inability to perform (e.g. the inability to deliver goods or services on a timely basis or to meet service-level agreements). In certain circumstances, an entity's estimate of penalties or liquidated damages could be limited by force majeure clauses. Further, an entity may need to reconsider whether it will be able to achieve milestone payments, performance bonuses, trailing commissions based on renewals, or other performance-related fees.

If there is a reduction in the estimated revenues, a change in estimate may result in the reversal of revenue for variable amounts that were previously recognised as revenue (e.g. as a result of an increase in return reserves). Because of the significant uncertainty associated with the pandemic's effects on an entity and its customers, it may be more challenging for the entity to make reliable estimates of variable amounts within revenue. Therefore, in a manner similar to its assessment of collectability (see below), an entity must document the judgements it made and the data or factors it considered, and ensure it has carefully considered how to constrain estimates of variable consideration.

Further, an entity may have received, or may have a right to receive, non-cash consideration (e.g. shares) from a customer, and that non-cash consideration may have declined in value. The entity should consider the specific facts and circumstances in order to determine whether that decline in value should be reflected as a reduction in revenue or, alternatively, should be accounted for under the FRS 102 requirements applicable to that particular type of non-cash consideration.

Reliable measurement

A general requirement of Section 23 is that revenue must be reliably measurable before it can be recognised. An entity is usually able to make reliable estimates after it has agreed with the other parties to the transaction each party's enforceable rights regarding the service to be provided and received by the parties, the consideration to be exchanged, and the manner and terms of settlement. However, in some cases, an effect of the pandemic may be that variable amounts within revenue can no longer be estimated with sufficient reliability to meet the recognition criteria. In such cases, revenue should not be recognised until the amount of revenue to be received can be measured reliably. Variable elements within revenue may arise from product returns, penalties, discounts, rebates and other similar

items.

Revenue recognition

Because of potential supply disruptions or other circumstances, an entity may need to reconsider the timing of revenue recognition if it is unable to supply goods or services on a timely basis.

For example, an entity may not be able to provide services due to government-mandated shutdowns (e.g. the temporary shutdown of a health club). In that circumstance, the entity may need to cease recognising revenue until it is able to perform. In addition, the entity must determine whether there are any contractual penalties that would affect the amount of revenue. In some cases, an entity may be completely unable to provide the goods or services that it had promised, which could result in (1) the termination of the contract, (2) a reversal of some or all of the revenue previously recognised, and (3) the recognition of a refund liability (or additional liability due to a payment of penalties) instead of deferred revenue.

Sometimes, delays in the transfer of goods or services may be caused by the customer or other external factors. For example, a customer may not be able to obtain physical possession of a product because of shipping delays or because it cannot receive the product (e.g. warehouse personnel may be unavailable). In such cases, an entity should carefully consider when the risks and rewards of ownership transfer (e.g. before or after shipment). Further, if a customer is unable to take physical possession of the product, it may request that the entity retain the product on a bill-and-hold basis. In this circumstance, the entity would need to consider the bill-and-hold guidance in FRS 102.23A.3.

An entity may also incur unexpected costs in providing services. If the entity is using the cost approach to measure the stage of completion of a service or construction contract, it should be careful to ensure that revenue attributed to work carried out is not increased to offset additional costs incurred when abnormal or excessive costs arise as a result of inefficiency or error.

If, at any stage, it is estimated that the future costs will exceed future revenue on a contract, the expected loss should be recognised as an expense immediately, with a corresponding provision for an onerous contract in line with Section 21 Provisions and Contingencies.

Collectability

For revenue to be recognised from the sale of goods, the rendering of services, or from construction contracts, Section 23 requires that it is probable that the economic benefits associated with the transaction will flow to the entity. If it is not probable that consideration will be received, no revenue can be recognised until either that consideration is received or it becomes probable that it will be received. To the extent that expectations of collectability deteriorate after revenue has already been recognised, this is dealt with through the recognition of an appropriate bad debt expense rather than reversal of the revenue previously recognised.

If the impacts of the COVID-19 pandemic result in a significant deterioration of customers' ability to pay, the entity should reassess collectability. For example, if a customer experiences liquidity issues or a downgrade in its credit rating, the entity would need to carefully evaluate whether those circumstances are short-term in nature or result in a determination that it is no longer probable that the customer has the ability to pay. Because of the significant uncertainty associated with the effects of the pandemic, it is important for the entity to document the judgements it made and the data or factors it considered. For example, the entity may determine that certain customers that are in financial distress will improve their liquidity position with government assistance. If the entity concludes that collectability is not probable, the entity can no longer recognise revenue.

Whilst the collectability analysis is performed at the individual contract level, an entity may look to a portfolio of similar contracts (e.g. by risk profile, size of customer, industry, geography, etc.) in its assessment. For example, if it is probable that an entity will collect substantially all the consideration for 90 per cent of a portfolio of similar contracts, and the entity is unable to identify specific contracts for which consideration is unlikely to be collected (i.e. the risk is the same for all contracts), the entity may conclude that it has met the collectability threshold for all the contracts in the portfolio. However, an entity should not ignore evidence related to specific contracts that do not meet the collectability criterion. In that circumstance, it should evaluate those specific contracts separately. Further, in determining which contracts are similar under a portfolio approach, an entity may need to consider disaggregating its contracts at a more granular level than it has in the past. For example, an entity may not have historically disaggregated its contracts by industry but may reconsider its disaggregation on the basis that some industries may be more heavily affected than others (e.g. hospitality, travel).

Loyalty awards

To mitigate any decline in sales, an entity may offer its customers sales incentives, including discounts on future goods or services, as part of a current revenue transaction. Although FRS 102 does not explicitly discuss the treatment of incentives granted in this way, Section 23 has requirements for the treatment of loyalty awards. In these circumstances, the entity shall account for loyalty award credits as a separately identifiable component of the initial sales transaction, allocating the fair value of consideration received or receivable between the award credits and other components of the sale, based on the proportionate fair values of the credits and other components. The amounts allocated to the award credits are deferred and recognised when the entity has fulfilled its obligations in respect of the award credits. A similar approach will typically be appropriate when an entity offers its customers other forms of sales incentives, such as

discounts on future goods or services, as part of a current revenue transaction. In effect, part of the amount payable by the customer under the current transaction would be allocated to these future discounts, and deferred until such time as the incentives are redeemed or lapse.

In addition, where amounts are being deferred in relation to loyalty awards or other sales incentives, an entity may need to update its estimate of the fair value of the awards or incentives (e.g. because the entity extended the periods for use or provided additional incentives to a customer, or because of changes in expected usage levels). For example, an entity may modify its loyalty programme by extending customers' ability to use points; this change may require the entity to reassess the assumptions it uses both to determine the amount that should initially be deferred and to determine when the amount deferred should subsequently be recognised as revenue.

Deferred payments

To assist customers that are experiencing liquidity issues in purchasing goods and services, an entity may provide extended payment terms. When the inflow of cash or cash equivalents is significantly deferred, and the arrangement constitutes in effect a financing transaction, the fair value of the associated revenue is determined as the present value of future receipts, determined using an imputed rate of interest. The difference between the nominal amount of the consideration to be received and the discounted amount should be recognised as interest revenue over the credit period using the effective interest method. In addition, while the extension of payment terms does not in and of itself indicate that an amount is irrecoverable, an entity may need to consider its procedures for assessing collectability as noted in the Collectability discussion above.

Implied performance obligations

There may be instances in which an entity provides free goods or services to its customer that are not part of a prior transaction or contract with that customer (i.e. when the prior transaction was entered into, there were no explicit or implicit obligations to provide those goods or services). An entity must carefully evaluate whether the additional promised goods or services are a modification of a pre-existing customer contract or a cost incurred that is separate from any pre-existing contracts.

In addition, an entity should consider the substance of the arrangement to provide the free goods or services and whether accounting for the arrangement as a separate transaction or as a contract modification would faithfully depict the recognition of revenue related to the goods or services promised to the customer in a pre-existing contract. In many cases, free goods or services provided to a customer solely as a result of the COVID-19 pandemic (that are not part of another newly entered contract with that customer) will not be considered a contract modification, in particular if they are broad-based and not negotiated with the customer (e.g. an internet service provider increasing monthly data allowances without additional charge for all customers for a three-month period to support working from home and home-schooling activities). However, an entity may need to determine whether it has developed a practice that creates an implied promise in future contracts.

Disclosure requirements

Many of the circumstances described above could affect an entity's disclosures. Given the level of uncertainty caused by the COVID-19 pandemic, an entity may find it challenging to make certain critical estimates. Therefore, it is important for the entity to disclose any significant judgements and estimates it makes in accounting for its revenue (e.g. assessing recoverability of consideration receivable, estimating the stage of completion for the rendering of services and contracts in progress, and measuring the revenue recognised in the period from rendering of services and construction contracts).

Restructuring plans

In a difficult economic environment and facing difficulties in obtaining financing, an entity may be considering or implementing restructuring plans such as the sale or closure of part of its businesses or the downsizing (temporarily or permanently) of operations. Plans such as these may require consideration of a number of issues, including whether the entity has a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it. If, and only if, both of these criteria are met at the reporting date, a restructuring provision should be recognised in accordance with Section 21 Provisions and Contingencies. Where such decisions are taken after the year end, they may need to be disclosed as non-adjusting events after the reporting period. When by the reporting date an entity has entered into a binding sales agreement to dispose of assets and liabilities, these items should be disclosed separately by way of note only.

As part of a restructuring, an entity might also seek to dispose of certain assets or groups of assets as a means to raise funds or certain assets might become idle or be retired from active use. As indicated in FRS 102.17.20, depreciation of an asset does not cease when an asset becomes idle or is retired from active use unless the asset is fully depreciated. If the depreciation is calculated by reference to the usage of the asset, however, the depreciation recognised may be zero while there is no production. In any case, when an asset becomes idle, or is retired from active use, this may trigger the recognition of an impairment loss which will result in the reduction of the carrying amount of the asset to its estimated recoverable amount.

Onerous contract provisions

At the inception of an executory contract, both parties to the contract expect to receive benefits that are equal to or greater than the costs to be incurred under the contract. Because of the impacts of COVID-19, unavoidable costs of meeting the obligations under the contract may exceed the benefits expected to be received, resulting in an onerous contract. Section 21 Provisions and Contingencies requires a provision to be recognised where a contract becomes onerous.

In its thematic review, the FRC highlights the need for transparent disclosure of the impacts of COVID-19 and that management should “clearly disclose the nature of the obligation and the expected timing of the outflow as well as to disclose any significant judgements or estimates in cases where COVID-19 related provisions have been recognised”

Examples of contracts for which an onerous contract provision may be required include:

- Increased costs of fulfilling a customer contract due, for example, to the replacement of staff who have tested positive for COVID-19, are subject to quarantine or are otherwise restricted from travel; or having to purchase alternative raw materials at a higher price due to supply chain issues; and
- Operating lease contracts.

The provision recognised for an onerous contract should reflect the least net cost of exiting from the contract, i.e. the lower of:

- The cost of fulfilling the contract; and
- Any compensation or penalties arising from failure to fulfil the contract.

In determining the least net cost of exiting the contract, an entity should pay attention to terms of the contract that allow the entity to terminate the contract without incurring penalties in certain extraordinary circumstances (“force majeure”). If a contract includes such a force majeure provision that can be enacted as a result of the COVID-19 pandemic, it may be that the contract is not onerous because the entity can avoid any further obligations.

FRS 102.21.11B is clear that provisions should not be recognised in respect of future operating losses. This includes situations where future operating losses relate to an activity that will continue, albeit in a restructured form, and are presumed to be avoidable (e.g. by an immediate closure of the loss-making activities); in such cases losses are recognised as the activity occurs.

Insurance recoveries

Entities that incur losses stemming from the COVID-19 pandemic may be entitled to insurance recoveries. For example, losses associated with increased medical claims, asset impairments, or shareholder litigation may be considered insured losses by many entities. Furthermore, entities may have business interruption insurance that provides coverage for lost profits due to a suspension of their operations. It may also be the case that an entity with a present obligation can seek reimbursement of part or all of the expenditure from another party, for example via an insurance contract arranged to cover a risk, an indemnity clause in a contract or a warranty provided by a supplier.

The basis underlying the recognition of a reimbursement is that any asset arising is separate from the related obligation. Consistent with the requirements of FRS 102 Section 21 on contingent assets, such a reimbursement should be recognised only when it is virtually certain that it will be received if the entity settles the obligation.

Note that it is the existence of the reimbursement asset that must be virtually certain, rather than its amount. An entity may be virtually certain that it has insurance to cover a particular provision, but it may not be certain of the precise amount that would be received from the insurer. Provided that the range of possible recoveries is such that the entity can arrive at a reliable estimate, it will be able to recognise this as an asset, even though the amount ultimately received may be different.

However, a conclusion that potential insurance recovery is virtually certain will involve significant judgement and should be based on all relevant facts and circumstances. In determining whether the threshold for recognition of a reimbursement asset is met, an entity will most likely, among other factors, need to understand the solvency of the insurance carrier and have had enough dialogue and historical experience with the insurer related to the type of claim in question to assess the likelihood of payment.

Other potential challenges an entity may encounter when evaluating whether a loss is considered recoverable through insurance include, but are not limited to, (1) the need to consider whether losses stemming from a pandemic are specifically excluded as a covered event; (2) the extent of coverage and limits, including multiple layers of insurance from different carriers; and (3) the extent, if any, to which the insurance carrier disputes coverage. Consultation with legal counsel may also be necessary.

Leases

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

For lessees with finance leases, impairments to a leased asset could occur as a result of business closures, supply chain disruption, or other consequences of the pandemic that negatively affect the future cash flows expected to be derived from the use of the underlying asset. Finance lease assets measured applying a cost model are carried at cost less any accumulated depreciation and any impairment

losses. Impairment is assessed applying the requirements in Section 27 as discussed above.

FRS 102 is silent on the subject of modifications to lease agreements for finance leases. However, as discussed below there are proposed amendments to FRS 102 with respect to operating leases where rent reductions or concessions have been offered by the lessor

Amendments to FRS 102 COVID-19-related rent concessions

Lessees in some affected markets are receiving rent abatements, payment holidays, or other economic incentives as a result of COVID-19. Section 20 Leases did not previously specify how to account for changes in lease payments that result from such rent concessions. There were differences of opinion over how the requirements of FRS 102 should be applied to such changes, specifically those arising from forgiven payments in operating lease agreements. In order to avoid differing accounting treatments in financial statements where changes in lease payments had arisen under similar circumstances, the FRC has issued Amendments to FRS 102 and FRS 105 – COVID-19-related rent concessions. These amendments introduce explicit requirements for accounting for temporary rent concessions for operating leases occurring as a direct consequence of COVID-19. The amendments apply to both lessees and lessors.

These amendments require lessees to recognise changes in operating lease payments (such as payment holidays or reductions in lease payments) and lessors to recognise changes in operating lease income that arise from COVID-19-related rent concessions on a systematic basis over the periods that the change in lease payments is intended to compensate

This accounting treatment only applies if, and only if all of the following criteria are met:

- the change in lease payments results in revised consideration for the lease that is less than the consideration for the lease immediately preceding the change;
- any reduction in lease payments affects only payments originally due on or before 30 June 2021; and
- there is no significant change to other terms and conditions of the lease.

The FRC considers that this would best reflect the economic substance of the benefit of these concessions and their temporary nature and improve the consistency of reporting for users of financial statements. The effective date for these amendments is accounting periods beginning on or after 1 January 2020, with early application permitted.

Consolidation

The COVID-19 pandemic may give rise to specific transactions or events that could change a reporting entity's governance rights over other legal entities and thereby affect accounting conclusions for consolidation.

In particular, loan agreements will commonly confer upon the lender rights that can be exercised in the event of the borrower breaching a loan covenant and/or defaulting on payments due under the loan agreement (e.g. the right to seize an asset provided by a borrower as collateral). Frequently, such rights are not considered to give the lender control of the borrower. However, in some circumstances, the rights may give the lender control over the borrower on the occurrence of a breach or default.

When a lender's rights under a loan agreement are enforceable upon default or breach of a loan covenant by the borrower, in some circumstances the lender will have obtained control of the borrower. In determining whether it has obtained control over a borrower defaulting on a loan or breaching a covenant, a lender should consider:

- Whether the lender's rights have been amended as a result of the default or breach to give the lender control over the borrower; or
- Whether the terms of the loan agreement were originally designed to give control in the event of a default or breach.

When the rights give the lender control over the borrower in the event of a default or breach such that the lender has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities, the lender has control over that entity.

Reporting time lags and consistency of accounting policies

Section 9 Consolidated and Separate Financial Statements requires that for purposes of the consolidated financial statements, the reporting date of a subsidiary corresponds to the date of the consolidated financial statements, unless it is impracticable to do so. When this is the case, the parent should consolidate the financial information of the subsidiary using the most recent financial statements of the subsidiary adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements. In any case, the difference between the date of the subsidiary's financial statements and that of the parent's financial statements should be no more than three months and the length of the reporting periods and any difference between the dates of the financial statements should be the same from period to period.

Section 14 Investments in Associates includes similar requirements in respect of the financial statements of an investee that an investor uses when applying the equity method.

In the current circumstances, if there is a time lag between the reporting date of a subsidiary and the consolidated financial statements (or between the reporting date of an equity method investee and the investor) it may be more likely that significant transactions or events will arise in the intervening period which will require adjustments to the financial statements of the subsidiary (or the equity method investee).

When a subsidiary prepares financial statements to a different reporting date, it is also necessary to review the subsidiary's statement of financial position to ensure that items are still correctly classified as current or non-current at the end of the group's reporting period. For example a breach of covenant that is determined to be a non-adjusting event in the financial statements of a subsidiary may require reclassification of the affected liabilities in the consolidated financial statements if these are prepared at a date after the date of the breach in covenant and if the lender has not waived its right to demand repayment for a period of at least 12 months from the date of the consolidated financial statements.

Business combinations

The COVID-19 pandemic may be causing delays in closing financial transactions, including business combinations. A business combination is recognised on the date on which the acquirer obtains control of the acquiree. Appropriate identification of the acquisition date is key as it is the date on which the acquirer begins consolidation of the acquiree. It is also the date on which the acquirer measures, generally at fair value, the consideration transferred and the identifiable assets acquired, the liabilities assumed and any non-controlling interest and previously held interest in the acquiree.

Defined benefit plans

The significant economic uncertainty associated with the COVID-19 pandemic will affect the measurement of defined benefit obligations and plan assets.

Section 28 Employee Benefits requires an entity to determine the present value of defined benefit obligations and the fair value of plan assets at the end of each reporting period.

An entity's considerations related to the fair value measurement of financial and non-financial assets also apply to the measurement of plan assets under Section 28. Pension plans may hold significant amounts of assets that do not have an active market, such as investments in hedge funds, structured products, and real estate assets that may become more illiquid, making their valuation more complex. Appropriately determining the fair value of such assets is important in the determination of the funded status of a defined benefit plan.

For some entities, plan deficit or minimum funding requirements can result in large cash outflows and, in some circumstances, this could affect the ability of an entity to operate as a going concern (see [Going concern](#)). As a result of the financial impact of COVID-19, some entities may need to consider how to preserve cash to provide much needed liquidity. FRS 102.28.41(a) requires an entity to provide an indication of the effect of the defined benefit plan on the entity's future cash flows.

Share-based payments

Some businesses may cease operations or operate at reduced capacity as a result of the impacts of COVID-19, which could affect the probability that vesting conditions for share-based payments with performance conditions will be met. Section 26 Share-based Payment requires entities to recognise compensation expense for a share-based payment arrangement with a performance non-market condition in situations in which the outcome of the performance condition is probable. For example, if an award contains a non-market performance condition that affects vesting (such as an award that vests if a certain growth in profit is met) and it is not probable that the performance condition will be satisfied, any previously recognised compensation expense should be reversed. However, market conditions, such as a target share price upon which vesting is conditional and non-vesting conditions, are taken into account when estimating the fair value of the equity instruments granted. Therefore, for grants of equity instruments with a market or non-vesting condition, an entity needs to continue recognising compensation expense if it is probable that all other vesting conditions will be met (e.g. service conditions), irrespective of whether the market or vesting condition is satisfied.

In addition, entities may decide to modify the terms or conditions of an equity-settled award, for example a change in the fair value-based measure, vesting conditions, or classification of the award. As a result of the modification, entities may need to recognise additional compensation expense for any incremental value provided (if the modification increases the fair value of the awards or additional awards are granted), or adjust the probability that the awards will vest in measuring compensation expense (if the vesting conditions are changed in a manner beneficial to the employees).

The cancellation of an equity instrument, by the entity or the counterparty, is accounted for as an acceleration of vesting. The amount that would otherwise have been recognised for services received over the remainder of the vesting period is, therefore, recognised immediately. If new equity instruments are granted and they are identified, on the date when they are granted, as replacement equity instruments for the cancelled equity instruments, this is accounted for as a modification of the original equity instruments. Entities should be aware of the tax consequences that may be triggered by the cancellation or modification of share-based compensation awards.

Other employee benefits (including termination benefits)

Entities may be considering (or implementing) restructuring plans to mitigate their exposures associated with unforeseen consequences of the COVID-19 pandemic. Immediate actions may include measures to reduce their workforce through temporary employee layoffs. Further, entities may be forced to consider subsequent restructuring actions as information becomes available on the long-term effects of the pandemic on an entity's operations. In addition, in certain jurisdictions, governments may facilitate programmes to alleviate

some or all of those costs (see the [Government Assistance](#) discussion below for further detail). In determining how to account for these measures, entities must start by identifying the nature and characteristics of each proposed action that is being considered because it may affect the timing of the recognition of the benefits provided to employees:

- **Stay bonus**—Some entities may offer special bonuses to employees as a reward for them working in these difficult conditions. Payments of these bonuses may be contingent on the employees continuing to provide services until a certain date. In such circumstances, the plan creates a constructive obligation as employees render service that increases the amount to be paid if they remain in service until the end of that specified period. The fact that some employees may leave without receiving payments offered under the bonus plans is reflected in the measurement of the obligation. It is not appropriate to defer recognition of the obligation until the employee completes the entitlement period.
- **Salary continuation, temporary suspension of employment**—Some entities may offer to continue to compensate employees even though they are not actively working during the suspension period, keeping the right to call employees back to work as necessary and preventing employees from taking up work elsewhere during the suspension period. When an entity uses a temporary suspension arrangement of this nature in order to reduce its employment costs during periods of reduced activity, the costs of the temporary suspension should be classified as a short-term benefit similar to a paid absence (e.g. holiday or leave pay). Short-term paid absences only give rise to a liability when they are accumulating, as discussed in FRS 102.28.6 and 28.7. This is not the case in the circumstances described, because the employees only have a right to receive payments as suspension occurs and for as long as suspension lasts. The entity has the discretion to ask some or all of its employees to return to work when the conditions will permit and revert to normal working arrangements and remuneration. Therefore, in these circumstances, the costs of suspension should be recognised over the suspension period and should not be accrued at the outset. Note that, in the circumstances described, the payments should not be classified as termination benefits; they are paid in exchange for suspension of the employees' employment rather than in exchange for termination of the employees' employment (as would be required under the definition of termination benefits in FRS 102.28.31-35)
- **Termination benefits**—If benefits are provided by the entity as a result of termination of employment, the entity should recognise its obligation immediately in profit or loss when the entity is demonstrably committed either:
 - to terminate the employment of an employee or group of employees before the normal retirement date; or
 - to provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.

Long-term intra-group foreign investments

Paragraphs 12 and 13 of Section 30 Foreign Currency Translation require gains and losses on monetary items that form part of a reporting entity's net investment in a foreign operation to be recognised in other comprehensive income in the consolidated financial statements that include the foreign operation. For an item to qualify as part of its net investment in a foreign operation, the entity must be able to assert that "settlement is neither planned nor likely to occur in the foreseeable future".

An entity that has characterised an intra-group item as part of its net investment in the entity may need to reassess whether that designation is still appropriate in the current economic environment. For example, an entity that plans to undergo restructuring because of the COVID-19 pandemic may need to reassess whether certain intercompany loans that had previously been determined to be of a "long-term investment nature" should continue to be accounted for as such if the loans could now be settled in the "foreseeable future" in connection with the restructuring plan.

Government assistance

In response to the COVID-19 pandemic, governments in many jurisdictions are considering, or have implemented, legislation to help entities that are experiencing financial difficulty stemming from the pandemic. Such assistance may be in the form of income-based tax credits that are dependent on taxable income or other forms of relief that is not dependent on taxable income (e.g. payroll tax credits, tenant reliefs and other similar subsidies). In its thematic review, the FRC notes that it expects "management to state clearly the support packages they have taken advantage of and to provide an accounting policy to explain how they have been accounted for".

Section 24 Government Grants has a broad scope exception encompassing "government assistance that is provided for an entity in the form of benefits that are available in determining taxable profit or tax loss, or are determined or limited on the basis of income tax liability". Such benefits may instead fall within the scope of Section 29 Income Tax. It will be necessary to look carefully at the substance of the particular credit, including the requirements that must be met in order to generate the credit and how the credit will be realised in practice.

Some relief programmes will clearly be in the scope of Section 24 because they are calculated and distributed to an entity without any link to taxable income (this may be the case for subsidies granted with respect to salaries of employees on temporary suspension). Other relief programmes will be clearly in the scope of Section 29, for example, deferral of payment of income tax or temporary changes in the income tax rate applicable to an entity.

When a government provides support to an entity through investment tax credit, it may be appropriate to analogise to either Section 24 or Section 29, depending on the substance of the support. Generally, if the arrangement resembles a tax credit, Section 29 would appear appropriate. A credit would therefore be recognised in profit or loss as part of income tax expense/income, and the related asset in the

statement of financial position, when the entity satisfies the criteria to receive the credit (and the government measure is substantively enacted). If the substance of the arrangement is considered to be closer to a government grant, and Section 24 is applied, the credit will be recognised in profit or loss over the periods necessary to match the benefit of the credit with the costs for which it is intended to compensate.

Government support may also be provided as forgivable loans or low interest loans. A forgivable loan from government, for which the government has undertaken to waive repayment under certain prescribed conditions, is treated as a government grant when there is reasonable assurance that the entity will meet the terms for forgiveness of the loan. The benefit of a government loan at a below-market rate of interest is also treated as a government grant. The loan is recognised and measured in accordance with Section 11 or Section 12. The benefit of the below-market rate of interest is measured as the difference between the present value of the future payments and the proceeds received, discounted at a market rate of interest.

Under Section 24, the effect of a government grant is recognised when, and only when, there is reasonable assurance that the entity will comply with the conditions attaching to it and that the grant will be received

An entity should recognise government grants either under the performance model, whereby grants are recognised in income at the date when any performance-related conditions are met, or the accruals model, whereby grants are classified as relating either to revenue or assets, and recognised either systemically against the costs for which the grant is intended to compensate, or in income on a systematic basis over the expected useful life of the asset, respectively. The decision as to which model is used is an accounting policy choice to be made by class of grant. There is no definition of 'class' for this purpose and judgement should be exercised. In most cases an entity will have a single policy for all government grants.

In some cases, an entity may be entitled to claim from the government the reimbursement of certain employee costs incurred. The entity should recognise an asset for the grant receivable when the employee costs are incurred and it is reasonably assured that it will receive the grant. For example, an entity may have applied in June 2020 for a COVID-19 related government grant intended to compensate eligible employment costs to be incurred in July 2020. If the grant is conditional on the entity actually incurring employment costs in July 2020 and the government approving the eligibility of the costs, the grant receivable would be recognised only when the employment costs have been incurred and have been approved by the government, and when the entity is reasonably assured to receive the grant.

In other cases, government subsidies are available to entities that meet certain criteria (e.g. size or industry) but without further conditions (e.g. the subsidy is not conditional on the entity incurring certain costs or making certain investments). In these cases, having applied for the subsidy, the entity should recognise an asset once it concludes that the eligibility criteria are met and it is reasonably assured to receive it.

In certain cases, an entity may receive the funds from a government grant in advance of incurring the costs that are intended to be compensated by the grant. For example, an entity may receive on 1 April 2020 £4,800 intended to compensate 80% of the costs of furlough employees to be incurred in equal amounts in April and May 2020. If the entity calls back the employees to work before the end of May 2020, the entire amount of the grant must be repaid. Upon receipt of the cash, the entity would recognise the cash received with a corresponding liability. If the entity is reasonably assured that the employees will remain on furlough until the end of May 2020, it would recognise the benefit of the grant rateably over the 2-month period in accordance with their chosen accounting policy to apply either the accruals or performance recognition model (see below). If the entity ceases to be reasonably assured that the employees will remain on furlough until the end of May 2020, this is accounted for as a change in estimate. The amount of the grant income previously recognised in profit or loss is reversed and a liability to the government is recognised until the grant is repaid.

For performance model-grants, it will be important to identify the performance conditions that attach to the grant. Identifying the date of recognition will require a close inspection of the grant conditions, and the precise terms which make the grant's receipt and retention unconditional. Where there are no performance conditions, or conditions have already been fulfilled, the grant is recognised in income when the grant is receivable. Where a grant is received before the date that it is included in income, it is recognised as a liability on the statement of financial position.

For accruals model-grants classified as relating to revenue, care is needed in identifying which of the conditions give rise to costs and expenses, since those are the conditions that determine the period over which the grant is recognised in profit or loss. A grant related to revenue (e.g. reimbursement of employment costs) is recognised as part of profit or loss, either separately or under a general heading such as 'other income'. A grant related to the acquisition of an asset is recognised in the statement of financial position as deferred income, which is recognised in profit or loss on a systematic basis over the useful life of the asset. The effect of these requirements is that accrual-model grants should be presented separately in profit or loss. Entities applying FRS 101 or FRS 102 are not permitted to deduct the grant received from the related expense or from the carrying amount of the related asset because such accounts are Companies Act accounts and offsetting would conflict with the law. The restrictions in the Act do not apply to entities reporting in accordance with full IFRS Standards, where offsetting, as an accounting policy choice, is permitted.

Governments may be providing support to entities through programmes that do not result in recognition of income in the financial statements of the participating entities. For example, certain governments are offering short-term debt facilities, sometimes in the form of commercial paper, to support liquidity of entities that were financially sound before the COVID-19 pandemic. Eligibility to the programme may be restricted to entities meeting certain criteria such as size or a pre-COVID-19 credit rating of investment grade. To the extent that the interest rate paid by the borrower and other terms of the debt instruments reflect market conditions, the borrowing

does not include a government grant that requires recognition in the financial statements. Nevertheless, such support is considered government assistance under Section 24. Entities will need to consider if the significance of the benefit received is such that disclosure of the nature, extent and duration of the assistance is necessary in order to avoid the financial statements from being misleading.

More broadly, to comply with the disclosure requirements in FRS 102.24.6, entities should provide clear disclosure regarding the impact of government assistance measures in terms of eligibility, conditions and consequences as well as in terms of the underlying judgements they have made.

Reduction in levies

In response to the financial difficulties encountered by entities, in many jurisdictions, governments have agreed to reduce the rate on certain levies for a predetermined period of time. For example, some governments have provided entities with relief from property taxes for the period from 1 April 2020 to 31 March 2021. It is appropriate, in such circumstances, for entities not to recognise property tax expense for the corresponding period, in effect considering that the property tax rate is nil for the period. If material, the government assistance received should be disclosed.

Deferral of remittance of VAT

To help entities facing liquidity issues, some government have offered all entities in their jurisdiction the option to postpone for a fixed period remittance of sales tax collected by the entity on behalf of the government. Entities opting to defer payments are not charged interest by the government. If significant, entities will need to provide appropriate disclosure of their participation in the scheme, for example as part of their disclosure on cash management and liquidity risk.

Income tax

Entities should consider how profitability, liquidity, and impairment concerns that could result from the impacts of COVID-19 might also affect their income tax accounting under Section 29. For example, a reduction in current-period income or the actual incurrence of losses, coupled with a reduction in forecast income or a forecast of future losses, could result in a reassessment of whether it is probable that some or all of an entity's deferred tax assets can be recovered. Such assessments will be particularly challenging in situations in which the changes in current and projected future profitability actually result in, or are expected to result in, cumulative losses and the entity has not had a stable earnings history before the impacts of COVID-19. If declining earnings or impairments generate losses, entities also need to evaluate whether there is sufficient taxable income to fully or partially realise the related deferred tax asset.

In addition, when assessing probable future taxable profits, entities should also ensure the reasonableness of their business plan and its impact on future taxable profits and the consistency of assumptions compared to projections used in other financial statements estimates for elements that should be comparable (e.g. goodwill impairment). The assumptions used should reflect the conditions in existence at the reporting date (see [Events after the reporting period](#) for further information on the effect of subsequent events).

The timing differences used to calculate the deferred tax balances should reflect the manner in which the entity expects, at the end of the reporting period, to recover the asset or settle the liability. Accordingly, entities will need to consider whether strategies considered to address the challenges brought by the COVID-19 pandemic have an effect on the recognition and measurement of deferred tax amounts. This may be the case for example, if an entity plans to sell an asset to improve liquidity and the tax consequences of selling an asset are different from those resulting from using the asset in operations (the original intent of the entity).

Deferred tax consequences of adjustments to the carrying amounts of assets and liabilities (for example, as a result of impairment losses or decreases in the value of a pension surplus) will also need to be considered.

As permitted by Section 29, an entity may have not recognised deferred tax liabilities for timing differences associated with subsidiaries, branches and associates, and interests in joint arrangements, because it controls the reversal of the timing difference and it has been probable until now that the timing difference will not reverse in the foreseeable future. Conversely, it may have recognised deferred tax assets for timing differences associated with such investments because it was probable that the timing difference would reverse in the future (and it was probable that the deferred tax asset could be recovered). It may be appropriate to reconsider these conclusions if there is a change in intent with respect to repatriation of undistributed earnings in an investee to help with liquidity issues.

Tax relief and credits determined to be in the scope of Section 29 should be reflected in the recognition and measurement of tax amounts only when the tax measure is substantively enacted. The assessment of whether a measure is substantively enacted depends on the relevant local legislative process. When an entity is uncertain of whether it will meet the conditions to be eligible for a substantively enacted tax measure, it should apply the general requirements of Section 21. FRS 102 reporters may choose to look to the requirements of IFRIC 23 Uncertainty over Income Tax Treatments to assist in establishing an appropriate accounting policy. If an entity concludes that it is not probable that a taxation authority will accept its tax treatment, the entity should reflect the effect of the uncertainty in determining the related tax balances.

Other uncertain tax positions may also arise as a result of the consequences on the entity of COVID-19. This may be the case for tax positions related to transfer pricing arrangements, where previously prepared benchmarking studies to support the policy may no longer be valid. Here again, the general requirements of Section 21 would apply.

In the UK, tax residency of an entity is generally determined by country of incorporation or, where the entity is not incorporated in the UK, whether the business is centrally managed and controlled in the UK. This assessment is made based on factors such as where the highest level of decision-making (e.g. Board meetings) takes place. Travel restrictions may require entities to consider whether they have met all of the requirements to be resident in the UK for tax purposes.

Breach of covenants

Unstable trading conditions and shortages of cash may increase the risk that entities breach financial covenants. Entities should consider how the breach of a loan covenant may affect the timing of repayment of the related loan and other liabilities (e.g. it becomes repayable on demand) and how it affects the classification of the related liabilities at the reporting date.

If a breach occurs on, or before, the reporting date and the breach provides the lender with the right to demand repayment within 12 months of the reporting date, the liability should be classified as current in the entity's financial statements in the absence of any agreements made on or prior to the reporting date that give the entity a right to defer payment beyond 12 months after the reporting date.

In contrast, a breach of loan covenants after the reporting date is a non-adjusting event that should be disclosed in the financial statements if the information is material (including the stage of the discussions with lenders to address the breach, if applicable). A breach after the reporting date could create uncertainty that raises substantial doubt about the entity's ability to continue as a going concern.

Other accounting considerations

Cash and cash equivalents

Section 7 Statement of Cash Flows defines cash equivalents as short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Entities may need to consider whether investments classified as cash equivalents continue to meet the requirement for such a classification. If this is not the case, a change in classification of the investments may be required.

For example, entities should consider whether investments in funds, such as money market funds, have experienced a more than insignificant decrease in value. Also, clauses in the fund's documents may grant the fund manager the ability to restrict redemption in exceptional circumstances that may apply to the COVID-19 pandemic. When considering the impact of restrictions that may limit an investor's ability to redeem the units in the fund, consideration should be given as to whether those conditions exist at the reporting date, or are expected to exist in the short term following the reporting date, and therefore will limit the investor's ability to readily convert its units into a known amount of cash.

A change in classification as the result of a change in facts and circumstances is applied prospectively (i.e. the comparative period is not restated).

Capitalisation of borrowing costs

Section 25 Borrowing Costs allows an accounting policy choice that borrowing costs which are directly attributable to the acquisition, construction or production of a qualifying asset may be included as part of the cost of that asset. If the policy has been adopted, and an entity suspends activities related to development for an extended period, capitalisation of borrowing costs should also cease until such time as activities are resumed. As a result of COVID-19, entities may have interrupted the development and construction projects due to restrictions on activities imposed by government, cash flow difficulties or a desire to hold back development in uncertain market conditions. If this is the case, borrowing costs incurred during the period of suspension are not considered to be a necessary cost of development and therefore should be recognised as an expense.

Exchange rates

For practical reasons, it is common for entities that engage in a large number of foreign currency transactions to use a monthly or quarterly rate of exchange to measure those transactions in their accounting records and to disregard day-to-day fluctuations in exchange rates. When this approach is used, care must be taken to ensure that the result is not materially different from what it would have been if actual rates had been used for translation. As a result of COVID-19, entities may recognise large one-off transactions or be exposed to significant and unexpected movement in exchange rates. Entities will need to evaluate if foreign currency transactions should be analysed into shorter periods (e.g. quarterly periods, months or weeks) with an average rate determined for each, or even a date-specific exchange rate.

Distributable profits

Directors of UK companies wishing to make a distribution or share buy-back should consider the effect that subsequent losses, as a result of COVID-19 or otherwise, have had on profits shown in the relevant accounts used to determine profits available. Where subsequent losses have eroded profits shown in those relevant accounts, this may mean that the proposed dividend may no longer be able to be paid out to shareholders or may need to be reduced. Additionally, even when losses since the date of the relevant accounts have not eroded profits to the extent that the dividend may no longer be paid, in exercising their fiduciary duties, directors should consider whether in light of the effects of COVID-19 it is in the best interest of the company to still pay a dividend at all. In deciding on whether to make a distribution, directors must also have regard to their duty under section 172 of the Companies Act 2006 to promote the success of the company and report on how they have discharged that duty.

Where a dividend payment has been suspended, it is helpful to indicate when the period of suspension is expected to end or be reversed. Additionally if a dividend policy remains unchanged in light of COVID-19, the FRC has indicated that it is helpful to indicate how this links to the viability assessment.

Financial institutions, within the scope of Section 34 Specialised Activities, are required to disclose information that enables users of their financial statements to evaluate the company's objectives, policies and processes for managing capital. Disclosures of changes made to capital management in response to COVID-19 will be relevant for these entities.

In response to the financial difficulties encountered by entities, in many jurisdictions, governments have agreed to reduce the rate on certain levies for a predetermined period of time. For example, some governments have provided entities with relief from property taxes for the period from 1 April 2020 to 31 March 2021. It is appropriate, in such circumstances, for entities not to recognise property tax expense for the corresponding period, in effect considering that the property tax rate is nil for the period. If material, the government assistance received should be disclosed.

Deferral of remittance of VAT

To help entities facing liquidity issues, some government have offered all entities in their jurisdiction the option to postpone for a fixed period remittance of sales tax collected by the entity on behalf of the government. Entities opting to defer payments are not charged interest by the government. If significant, entities will need to provide appropriate disclosure of their participation in the scheme, for example as part of their disclosure on cash management and liquidity risk.

APPENDIX A: KEY CHANGES MADE SINCE PUBLICATION ON 30 SEPTEMBER 2020

Section	Change
Going concern	Clarification on disclosure requirements.
Financial instruments: liquidity risk management	Clarification on disclosure requirements.
Financial instruments: contracts to buy or sell commodities	New subsection added, replacing the subsection titled "financial vs non-financial assets and liabilities".
Restructuring plans	Guidance on accounting for idled assets added.
Leases: amendments to FRS 102	Confirmation of the amendments to FRS 102 for COVID-19 related rent concessions, replacing "proposed amendments to FRS 102".
Share-based payments	Clarification of the impact of market and non-vesting conditions and of the cancellation and replacement of awards.
Government assistance	Clarification of the timing of recognition of government grants and addition of new subsections addressing "reductions in levies" and "deferral of remittance of VAT"
Distributable profits	Clarification on disclosure required for financial institutions.



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