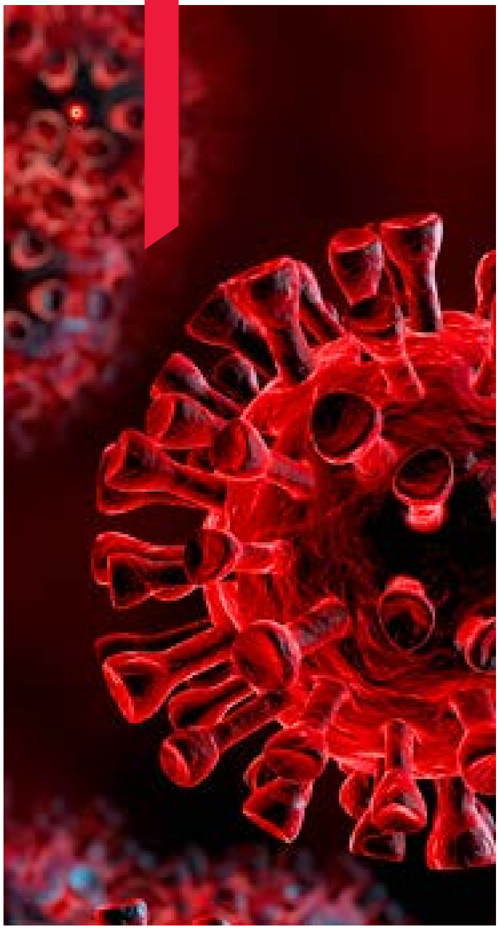
CHEAT SHEET

COVID-19: POTENTIAL FINANCIAL REPORTING IMPACTS



BACKGROUND

The first months of 2020 has seen the COVID-19 outbreak escalate into a global pandemic, and we, here at BDO New Zealand's *IFRS Advisory* department, hope that everyone is able to keep themselves and their families safe and healthy.

Such a significant and broad health crisis has caused (and will continue to cause) major economic disruption to all industries and sectors right across the globe.

Entities around during the Global Financial Crisis (GFC) of 2007/08 will recall that with economic disruption come areas of financial reporting that "float to the surface", and will need to be considered when entities are preparing their financial statements for the upcoming 2020 reporting year-ends.

BDO's Global IFRS department has recently released two guides recently addressing these financial reporting areas for entities with (click for links):

- 31 December 2019 reporting dates
- 2020 reporting dates (i.e. 31 March 2020, and 30 June 2020)

This *Cheat Sheet* has been produced as a high-level overview of these guides, to highlight the areas that entities will need to consider over the coming months as 2020 year-end financial statements are being prepared.

It also includes a quick checklist to assist entities in highlighting various application areas which may require specific attention.

NEED ASSISTANCE WITH NAVIGATING THE CONSEQUENTIAL FINANCIAL REPORTING REQUIREMENTS OF COVID-19?

BDO *IFRS Advisory* is a dedicated service line available to assist entities in navigating all things *(NZ) IFRS* related. Further details are provided on the following page for your information.

WHAT IS COVERED IN THE *CHEAT SHEET*

In order to navigate through this area of *(NZ) IFRS* reporting, this *Cheat Sheet* is broken down into the following sections:

1. The going concern assumption

This is by far the most important area that ALL entities (and their auditors) will need to consider at the outset.

Item *[NZ IFRS]*	Comments	Relevant to my entity?
Going Concern [*NZ IAS* 1] [*NZ IAS* 10]	At a minimum, going concern is assessed looking out 12 months from reporting date (or, if the entity is subject to audit in New Zealand, 12 months from the date the audit report is signed). The assessment is not just made at reporting date, but must also be (re)considered at all points in time during the period between reporting date and when the financial statements are ultimately signed (i.e. if the management determine that the entity is not a going concern during this period, the financial statements for the reporting period just ended are not prepared on a going concern basis). When an entity is not a going concern, the financial statements are essentially presented on a "liquidation basis", with: • All assets and liabilities being presented as current. • Assets remeasured to their realisable values. • Write-downs of carried forward tax losses and other deferred tax asset balances. • Recognition of provisions. Accordingly, the look, feel, and measurement of assets and liabilities in the financial statements is significantly different to that when financial statements are presented on *business-as-usual*, going concern basis. These areas (particularly the remeasurement of assets and recognition of provisions) may take time for an entity to address, and are not normally something that can be resolved on short notice if the going concern assumption changes just before the accounts are due to be signed. For a large majority of entities, determination of the going concern assumption is almost certainly going to be an area of **significant management judgement**. Accordingly, these entities will need to provide full, transparent, and entity-specific disclosures regarding the entities' ability to continue as a going concern, and any judgements and assumptions that management have used in coming to this decision (i.e. being able to service debt facilities, shareholder support, government assistance, on-going trading etc.).	**YES** (no choice, relevant to **ALL** entities)

2. Asset impairment, fair values, and recognition

Like the GFC, COVID-19 will potentially: **(i)** diminish an entity's ability to generate cash; and, **(ii)** exacerbate an entity's obligations to pay out cash.

In such situations, the recoverability of an entity's assets (and cash generating units (CGUs)) is jeopardised..

Item *[NZ IFRS]*	Comments	Relevant to my entity?
Trade and other debtors **Contract assets** **Lessor receivables** **Related party receivables** **Loans advanced** [*NZ IFRS* 9]	The ability of an entity's counterparty to repay their outstanding balances owed to the entity is directly related to the counterparty's own ability to generate cash – i.e. from their own future sales and settlement of their own receivable balances. The COVID-19 environment has put in significant economic barriers with respect to this, so it should be expected that almost **ALL** entities (not just banks and financial institutions) will need to revise (and downgrade) their expected future recovery of these receivables, even if counterparties **(a)** have a good credit history with the entity, and/or **(b)** have no overdue balances at year end. For most entities, it is highly unlikely that the assumption that provisions for bad debts will remain stable for the upcoming reporting dates will remain appropriate.	**YES / NO / ?**
Inventory [*NZ IAS* 2]	Inventory must be measured at the lower of cost or *net-realisable value*. The COVID-19 environment may push the prices of certain inventory items below their cost, and/or certain inventory product markets may dry up completely. Entities will need to monitor the sales price values and inventory turnover in the months subsequent to reporting date, and make adjustments to the carrying amount of inventory at reporting date if necessary.	**YES / NO / ?**
Non-current assets **Property, plant & equipment** **Intangibles** **Goodwill** **Lease *right-of-use asset*** **Cash-generating-units** [*NZ IAS* 36]	These assets are either tested for impairment annually, or are required to be tested when indicators of impairment exist. In the COVID-19 environment, indicators of impairment will almost certainly be present most entities. Impairment exists when an asset's *recoverable amount* is lower than its carrying amount, with the *recoverable amount* is the higher of either the assets: **(i)** **Value in use:** Typically determined using discounted cash flow models **(ii)** **Fair value less cost to sell:** Typically determined as the market price to sell the asset (less any sale costs) The COVID-19 environment will likely have various detrimental impacts to the parameters that underpin both of the above measures of *recoverable value.* For lease *right-of-use assets*, this is a similar assessment to the onerous lease assessments that have historically been undertaken for operating leases (prior to the adoption of *NZ IFRS* 16).	**YES / NO / ?**
Equity accounted investees (EAIs) Associates, Joint Ventures [*NZ IAS* 36]	There are a number of areas to consider with respect to the equity accounted carrying amount of an entity's EAIs: **(i)** Any long-term loans that the entity includes as part of the *net investment* in the EAI must first be considered for impairment as a receivable balance under *NZ IFRS* 9 (refer above), then **(ii)** The equity accounted carrying amount of an EAI is impaired (further) where there is objective evidence that the future cash flows of the EAI are jeopardised (as will likely be the case in the COVID-19 environment), and finally **(iii)** The carrying amount of an EAI can become a liability (i.e. "go negative") if, and only if, the entity has a legal (or constructive) obligation to make payments on behalf of the EAI (i.e. make-good its losses).	**YES / NO / ?**
Exploration and evaluation assets (extractive industry) [*NZ IFRS* 6]	*NZ IFRS* 6 allows entities the option of either capitalising or expensing costs related to exploration and evaluation activities. The measurement and impairment requirements are similar to those for non-current assets subject to *NZ IAS* 36 (above). The COVID-19 environment, and its impact to global commodity process, will likely have various detrimental impacts to the recoverable amounts of previously capitalised costs from exploration and evaluation activities.	**YES / NO / ?**
Deferred tax assets [*NZ IAS* 12]	*NZ IAS* 12 has strict recoverability criteria that must be met before an entity is permitted to recognise deferred tax assets (for both carried forward tax losses, and deductible temporary differences). The considerations are similar to those looked at when assessing the going concern assumption. However even if an entity is a going concern, this is not in and of itself determinative that it is probable future taxable profits will be generated to which the deferred tax assets can be utilised.	**YES / NO / ?**
Fair value assets **Investment property** **Share holdings** (both "passive", and investment portfolios) **Defined benefit plan assets** [*NZ IFRS* 13]	The fair value of assets represents the price that would be received to sell an asset in an orderly transaction between market participants, at a specific point in time (i.e. reporting date). The COVID-19 environment: • Is likely to negatively impact the market selling prices fort these assets as at the upcoming reporting dates, and • May make it challenging to estimate these market selling prices due to highly volatile markets, distressed sale prevalence, and/or a lack of an active market existing, and • Is not in and of itself determinative that an "active market" is not present and that a market price has become unobservable - even if there is a significant decline in activity on that market.	**YES / NO / ?**
Insurance receivables [*NZ IAS* 37]	Entities may have business interruption, or bad debtor insurance policies in place. The mere existence of an insurance policy against these losses is not in and of itself determinative that a receivable (and corresponding credit to profit or loss) can be recognised at reporting date. For such a receivable to be recognised it must be "virtually certain", which in practice has come to mean that the insurance company underwriting the policy has formally **(i)** accepted the claim, and **(ii)** confirmed the amount and timing of the claim settlement.	**YES / NO / ?**

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3. Provisions and liability recognition

In situations like COVID-19, *NZ IFRS* may require certain liability balances to be recognised, as well as providing specific criteria that must be met before these liabilities can be recognised.

Item *[NZ IFRS]*	Comments	Relevant to my entity?
Onerous revenue and supplier contracts [*NZ IAS* 37]	Where the unavoidable costs of a contract exceed the economic benefits to be derived from the contract, the contract is deemed "onerous". In these situations, from the point the contract becomes "onerous", entities must recognise the full value of the expected deficit (as a provision, and corresponding expense). The COVID-19 environment may see entities: • Having to receive contractually pre-agreed prices for revenue contracts where the cost to fulfil is higher. • Having to pay contractually pre-agreed prices for supplier contracts where the on-sale price of the goods is lower.	**YES / NO / ?**
Restructuring costs **Employee termination costs** [*NZ IAS* 37] [*NZ IAS* 19]	The COVID-19 environment may see entities having to restructure their organisations, and in doing so, incurring restructuring costs and/or paying out termination benefits to employees. A provision for these costs is recognised when, and only when, there is a firm legal or constructive obligation from a past obligating event. Accordingly, a provision for these items is recognised when, and only when, the decision to restructure the entity that has been **(i)** approved by the board, **and** **(ii)** communicated to affected parties (i.e. employees, customers etc.).	**YES / NO / ?**
Financial guarantee contracts [*NZ IFRS* 9]	The COVID-19 environment may see entities who have provided guarantees to other third parties or related parties (i.e. loans and leases), now expecting to ultimately have to make-good on these guarantees. Where this is the case, liabilities for the financial guarantee contracts will need to be remeasured.	**YES / NO / ?**

4. Other areas of recognition and measurement

The wider facts and circumstances surrounding COVID-19 may highlight additional recognition and measurement areas to be navigated through with respect to other *NZ IFRS*'.

Item *[NZ IFRS]*	Comments	Relevant to my entity?
Variable consideraton [*NZ IFRS* 15]	The COVID-19 environment may result in *variable consideration* in contracts with customers needing to be revisited, including refunds, concessions, success based fees, bonus payments etc. This may introduce additional scenarios into an entity's *expected value* measurement determinations, and/or more aggressive negative side weightings. At all times, *NZ IFRS* 15's constraint conditions for recognising variable revenue need to be adhered to.	**YES / NO / ?**
Lease renewal and termination options **Lease modifications** [*NZ IFRS* 16]	The COVID-19 environment may see entities **(i)** having to reassess and change their decisions regarding the use (or non-use) of renewal and termination options, and/or **(ii)** receiving modified lease terms and conditions from lessors (i.e. to provide temporary relief, and/or entice lessees to continue with the lease. Such updates represent "lease modifications", and will require remeasurement of the lease liability and right-of-use assets (using updated, **current discount rates**).	**YES / NO / ?**
Share-based payment vesting [*NZ IFRS* 2]	The COVID-19 environment will likely impact a broad range of vesting conditions associated with share-based payments (commonly those with employees). Where the outlook of satisfying these conditions has diminished, this may result in "forfeiture accounting" being required for changes in the assessments of service conditions and other (non-market) performance conditions (i.e. reversing previous period's expense back through profit and loss as gains in the current year).	**YES / NO / ?**
Modified loan agreements [*NZ IFRS* 9]	As with lease contracts, the COVID-19 environment may see entities modifying the terms and conditions of loans they have received (liabilities), as well as loans they have advanced (assets) For loan liabilities, modifications that result in a 10% greater change in the present value of payments are treated as *de-recognition and immediate re-recognition* event (with any difference recognised in profit or loss). For loan assets, *NZ IFRS* does not provide a "fixed" % change threshold and entities must also consider the qualitative nature of the modification (i.e. does the modification provide temporary (long-term) relief such that the net economic value of the loan is not (is) significantly affected). As such entities (and their auditors) will need to consider the appropriate thresholds and/or relevant qualitative factors present, and apply the same *de-recognition and immediate re-recognition* treatment when the threshold is crossed.	**YES / NO / ?**
Hedge ineffectiveness **Hedge disqualification** [*NZ IFRS* 9]	The COVID-19 environment may result in decrease in hedge effectiveness, or even full disqualification from continuance of hedge accounting (i.e. if the hedged item e.g. (forecasted transactions) is no longer highly probable).	**YES / NO / ?**
Government support measures [*NZ IAS* 12] [*NZ IAS* 20]	In response to the COVID-19 environment, many governments (including New Zealand's) may extend various support measures to business, and individuals through businesses (i.e. wage subsidies). Entities will need to consider the specific nature and features of these support measures, to determine their appropriate accounting treatment (i.e. as income tax reductions, as government grants received, or as other mechanisms (leases, financial instruments etc.). Where support measures come in the form of income tax rate reductions, entities will need to consider whether the relevant law has been substantively enacted as at reporting date.	**YES / NO / ?**

5. Presentation areas

The wider facts and circumstances surrounding COVID-19 may require entities to (re)consider how their financial statements may need to be presented in order to comply with various aspects of *NZ IFRS*.

Item *[NZ IFRS]*	**Comments**	**Relevant to my entity?**
Current versus non-current [*NZ IAS* 1]	The COVID-19 environment may see: **(i)** Certain assets no longer being able to be consumed or settled in an entity's "normal operating cycle" – meaning they would fail "current" classification. **(ii)** Certain assets now being expected to be realised in the 12 months following reporting date (i.e. liquidation, asset sell offs) - meaning they would meet "current" classification. **(iii)** Liabilities no longer being able to be deferred unconditionally for a period of 12 months or more (i.e. breaches in bank covenants) – meaning they would fail "non-current" classification.	**YES / NO / ?**
Non-current assets held for sale [*NZ IFRS* 5]	As above, the COVID-19 environment may see entities expecting to realise certain non-current assets in the 12 months following reporting date. However, this fact in and of itself is not determinative to present and classify a non-current asset as "Held for sale" in the financial statements. *NZ IFRS* 5 has a number of other, strict criteria that must be met before this treatment is applied, including (but not limited to) that as at reporting date: **(i)** Management have **committed to a plan** to sell the asset; and **(ii)** Management are **actively** looking to locate a potential; buyer(s). Note that assets to be abandoned are not treated as "held for sale".	**YES / NO / ?**
Discontinued operations [*NZ IFRS* 5]	The COVID-19 environment may see entities reduce operations, components that are disposed of or cease operations. Where these meet the definition of a *discontinued operation*, they will require separate, and specific presentation and disclosure in an entity's balance sheet and profit or loss statement.	**YES / NO / ?**

6. Disclosure areas

The wider facts and circumstances surrounding COVID-19 may require entities to provide updated, specific disclosures with respect to those areas that are consequentially impacted.

Item *[NZ IFRS]*	**Comments**	**Relevant to my entity?**
Financial risk management [*NZ IFRS 7*]	*NZ IFRS 7* requires entities to may full, transparent, and entity-specific quantitative and qualitative disclosures regarding the nature and extent of risks arising from financial instruments. The COVID-19 environment with have wide ranging, but entity-specific impacts to an entities credit risk, liquidity risks, and market risk exposures. Accordingly, it is highly likely that many entities will need to revisit their financial risk management notes and update these so as to include consequential impacts from COVID-19.	**YES / NO / ?**
Fair value [*NZ IFRS 7*]	Fair value hierarchy disclosures may "shift down" into lower tiers as more fair values may need to be determined using a greater amount of unobservable inputs.	**YES / NO / ?**
Going concern [*NZ IAS* 1]	Refer to section **1. The going concern assumption** (above).	**YES / NO / ?**

Members of BDO's *IFRS Advisory* department come ready with real life experience in adopting *NZ IFRS* 16 and are therefore well placed to provide entities with the expertise and assistance they require.

For more information as to how BDO Accounting Advisory Services might assist with assessing the impact of COVID-19 and other areas of IFRS application, please contact James Lindsay at BDO *IFRS Advisory* (james.lindsay@bdo.co.nz ☎ +64 21 166 0844), and visit our webpage below.

https://www.bdo.nz/en-nz/ifrs-advisory