June 2020

ACCOUNTING 02/20

COMMUNICATION IN RELATION TO THE IMPACT OF COVID-19 ON ACCOUNTING AND REPORTING - DETAILED

1. Introduction

The identification of the SARS-CoV-2 virus, along with the resulting COVID-19 disease and its spread to territories outside China, has created havoc around the world. The pandemic's far-reaching impacts on the world's economies started to become clear during February 2020, when outbreaks in South Korea and in Italy were a precursor to developments that would take place on a worldwide scale.

The Malta Institute of Accountants has previously **published guidance** on the impact of COVID-19 on financial accounting and reporting . That guidance addressed the following areas:

- assessment of an entity's ability to continue as a going concern;
- assessment of whether the impact brought about by the pandemic should be considered to be an adjusting or a non-adjusting event; and
- high-level comments on the impacts of COVID-19 on subsequent reporting periods.

Members are encouraged to refer to that communication in respect of the first two points; the guidance set out therein continues to remain valid, both under International Financial Reporting Standards as adopted by the EU ("IFRSs as adopted by the EU") and under the Accountancy Profession (General Accounting Principles for Small and Medium-Sized Entities) Regulations, Legal Notice 289 of 2015 ("GAPSME").

This new communication addresses the impacts of COVID-19 on subsequent reporting periods in more detail.

2. The pandemic's impact on specific areas of accounting

The guidance considers the impact of COVID-19 on the following specific areas of accounting:

- **Non-financial Assets**
  - **Property, plant & equipment and investment property**
  - **Intangible assets**
  - **Capitalisation of borrowing costs**
  - **Impairment of non-financial assets**
  - **Fair value measurements of non-financial assets**
  - **Inventories**
- **Financial Instruments**
  - **Changes in intention for holding dept instruments**
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Non-Financial Assets

Property, plant & equipment and investment property

Under both IAS 16 and GAPSME, depreciation of property, plant and equipment commences when the asset is available for use. The closure of certain establishments, as well as the overall impact of COVID-19 measures taken locally and abroad are such that certain assets may be temporarily lying idle. Depreciation on such assets must continue during periods of temporarily lying idle. The same holds true for investment property that is measured under the cost model.

As an exception, if an entity calculates depreciation on a units of production basis, no depreciation will be charged if an asset is lying idle (or a low depreciation charge will be calculated if the asset is being used at below-normal levels). Such a scenario is however generally considered to be an internal indicator that an asset may be impaired, in which case an impairment test would be required.

Preparers are also required to reassess on an annual basis their estimate of an asset's useful life and residual value. The impact of COVID-19 should be considered when making such a reassessment, and any changes in estimates should be adjusted prospectively.

Intangible Assets

Under IAS 38, assets with indefinite useful lives are not amortised and are instead tested at least annually for impairment. Preparers are however also required to reassess on an annual basis whether the assessment of an indefinite useful life continues to remain valid. The impact of COVID-19 should also be considered when making such a reassessment, and any changes in estimates should also be adjusted prospectively.

Capitalisation of borrowing costs

Under IAS 23, an entity must capitalise borrowing costs that meet certain criteria (including that borrowing costs must be actually incurred to finance a qualifying asset, and construction or development of that asset must have commenced). Capitalisation of borrowing costs must however be discontinued if the construction or development is suspended; capitalisation recommences once construction or development is resumed.

Under GAPSME, entities have an accounting policy choice on whether to capitalise borrowing costs that meet the appropriate criteria. Entities that have previously elected to capitalise borrowing costs will be impacted in the same manner as described above under IAS 23.

Impairment of non-financial assets

Under IAS 36, goodwill and certain types of intangible assets require an impairment test to be carried out at least annually. Other non-current assets within the scope of IAS 36, together with most non-current assets under GAPSME, must be tested for impairment if there are indicators that the asset may be impaired; indicators that an impairment may exist include both internal and external indicators.

The impact of COVID-19 and the measures taken by governments worldwide give rise to a number of possible indicators that non-current assets may be impaired such as, to name but a few, changes in consumer behaviour leading to reduced and/or shifting demand for an entity's products or services, forced closures of premises, or assets lying idle or being used at low levels of productivity.

Preparers are required to test assets (or cash generating units) whenever such indicators exist. This may mean that the timing of carrying out impairment testing on goodwill and certain types of intangible assets may need to be brought forward, particularly if the annual impairment test is normally carried out towards the end of a reporting period and the entity is also required to publish interim financial statements under IAS 34.

When testing non-current assets for impairment, prepares must estimate an asset's (or cash generating unit's) recoverable amount, which is the higher of its value in use and its fair value less costs to sell.

A value in use calculation typically takes the form of a discounted cash flow analysis. Such an analysis must be carried out on the basis of the asset in its current condition, and must exclude the effects of enhancing the asset, as well as the effects of restructuring to which the entity is not yet committed. Amongst others, preparers should however bear the following in mind:

- discount rates must be pre-tax discount rates, and consideration should be given both to changes in the market risk-free rates of interest, as well as changes to an entity's risk premium; and
- risks specific to the asset (or cash generating unit) and to the sector and geographic region of operation must also be reflected in the value in use calculation.

The reflection of risk within the value in use calculations is a matter that always requires the use of supportable assumptions. However, the uncertainty brought about by the pandemic, the measures taken to address the pandemic, and the different scenarios of how the economy (and each sector) may recover, is such that the supportable assumptions will prove to be harder to justify. Preparers are expected to reflect this additional uncertainty through a greater risk adjustment in the value in use calculations. This may be achieved through the use of a risk-adjusted discount rate. However such a scenario may result in a highly complex calculation for an appropriately-weighted discount rate; any such resulting discount rate may accordingly be harder to justify.

Preparers may alternatively risk-adjust the projected cash flows, rather than risk-adjust the discount rate. Such an approach would involve the projection of multiple cash flows in different scenarios, weighting each scenario by a probability, and discounting each scenario with an unadjusted discount rate. Such scenarios could include different durations until the disruptions are normalised, as well as different assumptions on the severity of COVID-19's impact on the entity's cash flows under each scenario.

Fair value measurments of non-financial assets

Fair value measurements of non-financial assets are required in a number of instances, including where an entity has elected to apply a fair value measurement model (for example for investment property, or certain classes of property, plant and equipment), where an entity is required to calculate an asset's (or cash generating unit's) fair value less costs of disposal, or where an entity is identified as the acquirer in a business combination.

The COVID-19 pandemic has created volatility in prices, perhaps more evident in the case of financial assets for which there are organised and active markets, but also for non-financial assets.

IFRS 13 makes it clear that fair value measurements must be carried out from a market perspective, rather than from an entity-specific perspective. In addition, IFRS 13 provides a fair value hierarchy that obliges the maximisation of use of objective data when estimating fair value measurements. Accordingly, preparers must consider market movements when estimating fair values, and cannot ignore such market movements simply because the pandemic is hopefully a one-off event from which economies will fully recover.

That being said, preparers should consider whether the valuation approach adopted, for example a market approach as opposed to a value in use approach, continues to provide the most representative fair value in the circumstances. Any change in approach is considered to be a change in accounting estimate, and would accordingly result in a prospective application of the new measurement approach.

Entities preparing financial statements in accordance with GAPSME will not be impacted by IFRS 13, however preparers should bear in mind that medium-sized entities that measure assets under a fair value model are required to give certain disclosures about fair valuations carried out in the current reporting period, including the basis of the fair value estimate.

Inventories

Under IAS 2 and under GAPSME, inventories must be carried at the lower of cost and net realisable value. Slower stock movements, reductions in selling prices (whether due to direct reductions, or due to special offers such as offering customers two goods for the price of one), and increased risk of obsolescence (for instance, of perishable or fashion items of inventory), may all give rise to the need to write inventories down to their net realisable value.

For entities that add value to inventories, such as manufacturing entities, both IAS 2 and GAPSME allow for the absorption of fixed production overheads. The rate at which such overheads are to be capitalised into the cost of inventories must however reflect normal production levels. Therefore, reduced levels of production will result in an amount of those fixed production overheads having to immediately be recognised as an expense, rather than capitalised within the cost of inventories.

Financial Instruments

Changes in intention for holding dept instruments

Amortised cost accounting is not permitted under IFRS 9 unless the relevant portfolio (of similar financial assets) is managed with an objective to collect the instruments' cash flows[1]. Sales from within such a portfolio are therefore expected to be infrequent and insignificant. The effects of the pandemic may be such that management may reassess an entity's strategy for holding certain financial assets. Changes in the above intentions could have the effect of resulting in a change in an entity's objective for holding the portfolio. That being said, it is noted that not all changes automatically result in a change to the business model. For instance, one may be able to successfully argue that the business objective continues to remain unchanged (i.e. to hold the portfolio of assets to collect the instruments' cash flows) if it can be demonstrated that the higher volume of sales is a direct result of the pandemic (for example due to short-term liquidity needs arising from a drop in cash flows generated from operations), is temporary, and that future patterns of sales from within the portfolio will return to pre-pandemic levels once operating cash flows return to some form of normality.

A change in the objective (as opposed to temporary measures that may be consistent with the original objective) would however necessitate reclassifications to other categories of financial assets, with an implication that amortised cost accounting would no longer be permissible for the portfolio.

Meanwhile, debt instruments that are traded in an active market are measured at amortised cost under GAPSME if they are classified as 'held-to-maturity'; the entity must have the positive intention and ability to hold the instruments to maturity for such a classification to be permissible. A change in an entity's intention or ability will require preparers to assess whether amortised cost accounting continues to be permissible.

Credit losses on dept instruments

An allowance for credit losses must be recognised under IFRS 9 for all debt instruments other than those that are measured at fair value through profit or loss; the allowance is measured on the basis of the best estimate of what the future losses may be, even if there is no objective evidence of credit events having yet taken place. Indeed, the model is referred to as an expected credit loss model ("ECL").

Under the general model, preparers must assess whether a loss allowance should reflect:

- a 12-month ECL (for those counterparties who have not experienced a significant increase in credit risk); or
- a lifetime ECL (for those counterparties who have experienced a significant increase in credit risk, or who have defaulted).

Entities are required to measure a lifetime ECL for trade receivables and contract assets that do not include a significant financing component. A simplification (to measure lifetime ECL without assessing whether there has been a significant increase in credit risk) is also available for trade receivables that include a significant financing component,

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1 Other instrument-level conditions must also be satisfied for a financial asset to be measured at amortised cost.

as well as for lease receivables. Preparers may use a provisions matrix, reflecting an analysis of historical loss rates based on the ageing of receivables.

IFRS 9 however requires a forward-looking ECL estimate, and preparers will need to consider what forward-looking information can, and should, be reflected in the ECL estimates. Given the economic uncertainty of these unprecedented times, preparers should consider whether such forward-looking ECL estimates require a management overlay to be applied over and above the historical loss rates.

For other debt instruments, preparers will need to assess whether counterparties have experienced a significant increase in credit risk. Amongst many others, IFRS 9 suggests that the following occurrences may be relevant in making such an assessment:

- existing or forecast adverse changes in business, financial or economic conditions that are expected to cause a significant change in the borrower's ability to meet its debt obligations, such as an actual or expected increase in interest rates or an actual or expected significant increase in unemployment rates; and
- an actual or expected significant adverse change in the regulatory, economic, or technological environment of the borrower that results in a significant change in the borrower's ability to meet its debt obligations, such as a decline in the demand for the borrower's sales product because of a shift in technology.

In addition to determining the basis on which ECL loss allowances should be calculated, preparers will need to estimate the ECL itself. Consideration therefore needs to be given to the effect that the COVID-19 pandemic has had, and may continue to have, on the probabilities that counterparties will default, the exposure that the entity will have to such a counterparty at the time of a potential default, and the loss that will be suffered should a default actually take place. Assessments of the quality of guarantees, and value of security, will also likely be necessary.

Unlike IFRS 9, GAPSME adopts an incurred loss model. What this means in practice is that loss allowances are only recognised when there is objective evidence that an asset may already be impaired, such as significant counterparty financial difficulty, or defaults on contractual payments. Loss allowances are therefore generally recognised later under GAPSME than they would be under IFRS 9.

Impairment of financial assets other than dept instruments

Financial assets other than debt instruments are not subject to impairment assessments under IFRS 9.

Entities which comply with GAPSME have an accounting policy choice on whether to measure such instruments under a cost model or a fair value model[2]. Under the cost model, instruments are measured at the lower of cost and fair value less costs to sell. Subject to not resulting in an increase in an asset's carrying amount to a value that exceeds the asset's cost, any movements in fair value less costs to sell (including recoveries of previous losses) are recognised in profit or loss.

Where an entity has elected to apply the fair value model, any fair value gains or losses are recognised in profit or loss if the asset is held for trading; such financial assets are not subject to impairment assessments.

2 The ability to measure financial assets at fair value is subject to meeting certain conditions.

With available-for-sale financial assets that are measured at fair value, preparers must assess the assets for impairment whenever there is objective evidence that the asset may be impaired. A decrease in fair value less costs to sell may be one such indicator of impairment. If an impairment is identified, any losses accumulated in equity must be recycled through profit or loss.

Fair value measurments of financial assets

Fair value measurements for financial assets and liabilities must also be prepared in accordance with the requirements of IFRS 13 (which, as discussed previously, requires valuations to be calculated from a market perspective). IFRS 13 requires that where a security is actively traded in a market, fair value measurements are set at a value within the bid-ask spread. Adjustments to this price cannot be made where there are Level 1 values, even if there is a hope or an expectation that fair values will recover as economies start to recover.

Preparers must maximise the use of market-observable data in their fair value estimation if there is no active market for a financial instrument that needs to be fair valued. Whilst this is a process that entities may already have gone through in previous financial periods, careful consideration will need to be given to whether the increased volatility and uncertainty in the markets is such that what may have previously been a Level 2 valuation within IFRS 13's hierarchy may now become a Level 3 valuation. This would be the case if any inputs into the valuation model are unobservable and are significant to the entire measurement. Preparers should keep in mind that disclosure requirements for Level 3 valuations are significantly greater than they are for valuations within Level 1 and Level 2.

Liquidity risk

One of the objectives of IFRS 7 is for users to be given qualitative and quantitative information about an entity's exposures to, and management of, financial risks such as market risk, credit risk, and liquidity risk. Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. In preparing the related disclosures, preparers should assess an entity's financial obligations, its cash-generating abilities in an uncertain economy, and its ability to access additional funding. Consideration should also be given to existing funding, and whether such funding may be at risk of being withdrawn; a discussion on existing funding is included in the "Breach of covenants" section of this guidance.

Entities preparing their financial statements in accordance with GAPSME are not required to disclose information about liquidity risk, unless there is a doubt about the entity's ability to continue as a going concern (in which case, the implications will go beyond a disclosure in the financial statements if it is determined that an entity is not a going concern). However, preparers of medium-sized entities should bear in mind that under the Maltese Companies Act (Chapter 386 of the Laws of Malta), certain disclosures about exposures to risk may be required. A discussion on this matter is included in the below section, "Disclosures".

Leases

Exercise of options

Lease arrangements may contain options to extend or terminate a lease. Under IFRS 16, the lease term (upon which all calculations of lease payments are based) is reflective of the non-cancellable period of a lease, adjusted by extension or termination options if, and only if, it is reasonably certain that those options will be exercised. In addition, payments under a lease include the exercise price of a purchase option if it is reasonably certain that the lessee will buy the asset at the end of the lease term.

The developments brought about by the pandemic may give rise to a preparer having to reassess whether the exercise, or non-exercise, of such options continues to be (or ceases to be) reasonably certain. Changes in the reasonable certainty assessments are adjusted for through a prospective adjustment.

Contract Modifications

Lessees

The development of the pandemic, and the forced closure of certain businesses, has resulted in certain concessions being given by landlords to their tenants. The assistance may have taken the nature of payment holidays (or deferrals of payments), reductions of rent, or waivers of rent. From a lessee's perspective, such modifications need to be assessed to determine whether the concession was contractual (such that the lessee was already contractually entitled to such assistance), or non-contractual (such that the measure was granted by the landlord on the basis of relationships rather than contractual obligations).

For the avoidance of doubt, this guidance does not address whether the COVID-19 pandemic could be considered to be a force majeure event under Maltese law, and preparers whose lease contracts contain force majeure clauses are encouraged to seek legal advice should they determine that such a course of action is warranted. Similarly, this guidance also does not address whether changes in laws that required certain establishments to remain closed would constitute an event (under the general terms and conditions of a lease agreement) that triggers a contractual obligation on the part of the landlord to grant concessions.

In the event that the act of granting a concession was merely the execution by the landlord of a pre-existing contractual obligation, then we believe that it is justifiable to view the assistance as a (negative) variable lease payment, and the lessee would recognise a credit in the income statement in the same period(s) covered by the assistance.

On the other hand, if the assistance is not the result of the execution of a pre-existing contractual obligation, then the assistance is considered to be a lease modification[3]. With lease modifications, the lessee is required to re-calculate the present value of the remaining (adjusted) lease payments, discounted at a revised rate as applicable on the date of the modification; any difference between the re-calculated present value of the remaining lease payments, and the pre-modification carrying amount of the lease liability, is recognised as an adjustment to the lease liability and a corresponding adjustment

3 An amendment to IFRS 16 was issued by the IASB on 28 May 2020 through which lessees are, subject to meeting certain criteria, exempt from assessing whether a COVID-19-related lease concession constitutes a lease modification under the general requirements of IFRS 16. At the time of issuing this guidance, the amendment is however not yet endorsed by the EU, and the general rules in IFRS 16 must be applied until the amendment is endorsed.

to the right-of-use asset; such an adjustment cannot however result in the asset being reduced to a value of below nil, and any excess would need to be recognised in the income statement.

Lesssors

From the lessor's perspective, the accounting implications of a concession to the lease rentals (without any changes to the scope of the lease) will depend on whether the lease is classified as an operating or as a finance lease.

If the lease is an operating lease, as is often the case with leases of immovable property, the modified lease is recognised as a new operating lease, and all (revised) lease payments remaining at the date of modification are recognised as income on a straight-line basisover the remaining lease term; any prepaid or accrued lease payments relating to the original lease as at the date of modification are taken as an adjustment to the (revised) lease payments. In practice, the effect of the concession is spread over the remaining lease term.

If the modified lease is a finance lease and would just the same have been classified as a finance lease had the original contract been assessed on the basis of the revised (rather than the original) lease payments, the modified cash flows are discounted to present value using the original discount rate, and any difference between the resulting figure and the finance lease receivable immediately prior to the modification is recognised in profit or loss as a modification loss.

Revenue Recognition

Under IFRS 15, variable consideration is consideration whose amount can vary due to discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items. Consideration could also be variable as a result of selling goods with a right of return, or a result of milestone achievements triggering the payment of a pre-determined amount. Such contractual clauses give rise to uncertainty in the amount of total consideration under a contract.

A key aspect of revenue recognition under IFRS 15 is that variable consideration to which an entity is entitled should be estimated if preparers meet certain criteria, such as having sufficient knowledge and experience with the type of good or service being supplied, the type of arrangement, and the type of customer. However, variable consideration cannot be recognised as revenue in the income statement unless and until it is highly probable that amounts recognised will not be reversed when the uncertainty is resolved.

Even without having a pandemic, preparers need to apply judgement and make estimates whenever revenue contracts contain clauses that introduce variability. Such judgement and estimates will need to be reconsidered within the context of the COVID-19 pandemic.

In addition, the measures taken to combat the pandemic, as well as uncertainty in the exact nature and timing of an economic recovery, are such that preparers may no longer be in a position to support a judgement that it is highly probable that variable amounts of consideration will not be reversed when the uncertainty is resolved. For instance, given the uncertainty it may be a lot more challenging to estimate whether:

- milestones will be achieved;
- higher volumes of sales, triggering volume-based rebates, will be achieved;
- penalties will not (or will) be incurred; or
- performance bonus payments will be triggered.

The above, and other, considerations might result in the necessary deferral of income which in a pre-COVID-19 scenario would have been able to be recognised at an earlier stage.

Government Assistance

The Maltese Government has announced a number of assistance schemes, such as the scheme to subsidise employee benefits of €800 per month per full time employee in those sectors that have been critically impacted by the COVID-19 pandemic.

Both under IAS 20 and GAPSME, the objective of the requirements is to match the timing of government assistance in the income statement to the cost that the assistance seeks to mitigate, such as employee costs. Therefore, government assistance in the form of subsidies that compensate entities for costs that are recognised immediately in the income statement, such as wages and salaries, must also be recognised as a credit in the income statement at the same time.

Credits for government assistance cannot however be recognised unless there is reasonable assurance that the entity satisfies the conditions laid out by the government and that the grant will be received. Judgement may be required both in determining whether the qualifying criteria have been satisfied by the entity (which may not be the case if there is a substantive or judgemental vetting process that needs to validate all claims for assistance), as well as in determining whether there is reasonable assurance that the assistance will be received. The latter assessment will be of particular relevance where schemes have a finite ‘pool’ resulting in a situation in which entities that meet the criteria may just the same not receive the grant (or not receive the grant in full) if applications are oversubscribed.

In addition, if an entity has reasonable assurance that it satisfies the criteria to recognise the grant:

- any amounts credited to the income statement but not yet received from the Government are recognised as an asset; and
- any amounts already received from the Government, but that compensate an expense that is yet to be recognised in the income statement must be recognised as a deferred grant (and presented within liabilities) until that time when the subsidised costs are recognised as an expense.

This guidance note does not address other forms of government assistance, such as assistance to subsidise the cost of an entity’s capital expenditure.

Non-financial rights and obligations

Provisions

Under both IAS 37 and GAPSME, a provision is a liability of uncertain timing or amount. No provision is recognised unless all the following three criteria are satisfied:

- the entity has a present obligation (legal or constructive) as a result of a past event;
- it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation.

As a result, provisions may not be recognised for future operating losses. Provisions are however recognised for onerous contracts, which are contracts under which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The provision is measured at the lower of:

- the estimated losses that will be incurred if the contractual obligations are honoured; and
- the penalties that would be incurred to terminate the agreement.

Meanwhile, entities impacted by the pandemic may also undertake restructuring exercises, such as the sale or closure/termination of operating sites or lines of business. Restructuring provisions may only be recognised where there is a detailed formal plan for the restructuring, and management has raised a valid expectation in those affected by the plan that it will go ahead with the restructuring. Such a valid expectation may include starting to implement that plan, or announcing its main features to those affected by it (such as customers, suppliers and employees).

All provisions must be discounted to present value if the effect of time value of money is material.

Insurance claims

The COVID-19 measures may have given rise to entities making insurance claims, for example for compensation under a business interruption insurance policy. Under both IAS 37 and GAPSME, a contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

Contingent assets from insurance cover can only be recognised when recovery is virtually certain. Preparers will need to apply judgement in determining then this threshold is met, however it will usually not be met until the insurer has acknowledged that the policy covered the event, and the insurer and the insured have a basic understanding of the amount of compensation.

When an entity is satisfied that the above conditions are satisfied, which may occur later than when the entity incurs the losses being compensated, any such contingent asset is recognised as an asset, separately from any related provision.

Income Taxes

Under both IAS 12 and GAPSME, deferred tax assets are recognised only to the extent that it is probable that the asset will be realised. Additionally, compelling evidence supporting its recognition is required in those cases in which an entity has registered a loss. Preparers will need to bear in mind the developments and uncertainty caused by the pandemic in making such an assessment.

Breach of Covenants

Under both IAS 1 and GAPSME, a liability is presented as current if, amongst others, the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the end of the reporting period[4]. Non-current liabilities are all those liabilities that are not current.

Entities may be a party to borrowing agreements under which they are subject to covenants. If an entity breaches those covenants, users will need to carefully assess what implications such a breach may have on the entity's rights to defer settlement for at least twelve months after the end of the reporting period. Should the breach of a covenant trigger a contractual right for the lender to demand immediate payment (notwithstanding the original payment schedule), preparers must assess whether the borrower continues to have an unconditional right to defer settlement of the liability for at least twelve months. This will typically not be the case, unless there are cross-breaches by the lender, in which case preparers are encouraged to consider whether they should seek legal advice.

The presentation of financial liabilities as current or non-current must reflect the contractual rights and obligations as they stood at the end of the reporting period. Thus, the successful renegotiation of covenants or the rectification of breaches are non-adjusting events after the reporting period if, at the end of the reporting period, an entity did not have an unconditional right to defer settlement for at least twelve months after the end of the reporting period as a result of a breach of covenants. Any such renegotiations or rectifications of breaches would however be a matter for disclosure.

In extreme cases where negotiations do not take place, or where negotiations are not successful, preparers will need to assess whether the breach of covenants has wider implications on an entity's ability to continue as a going concern.

Disclosures

Preparers will need to be mindful of the specific disclosure requirements for each of the areas considered in this guidance. For example, when preparing financial statements in accordance with IFRSs as adopted by the EU, specific disclosures are required in respect of each of the following matters. The following list is indicative, rather than exhaustive:

- useful lives and residual values of non-current assets, including reasons supporting the conclusion that intangible assets have an indefinite useful life;
- assumptions used, and results of, impairment tests carried out (with disclosure

4 An amendment to IAS 1 that was issued by the IASB on 23 January 2020 changes the requirement from being an assessment of whether an entity has an "unconditional right" to whether an entity has a "substantive right"; this change addresses the reality that rights are rarely unconditional due to the existence of covenants. At the time of issuing this guidance, the amendment is however not yet endorsed by the EU.

requirements increasing in those instances where an impairment loss has been recognised, or when there is goodwill or intangible assets with indefinite useful lives);

- assumptions made when estimating fair values that fall within Level 3 of IFRS 13's fair value hierarchy;
- descriptions of the general terms of lease arrangements, including the existence of exercise or termination options (consideration must also be given to whether the achievement of IFRS 16's objectives requires disclosure of the judgements made in this regard);
- specific estimates and judgements made in measuring an entity's revenue under IFRS 15.

Meanwhile, IAS 1 contains overriding disclosure requirements in respect of a preparer's use of judgements and estimates. IAS 1 specifically requires preparers to disclose information about those judgements made (in applying an entity's accounting policies) and that have the most significant effect on the amounts recognised in the financial statements. Such judgements could include a number of factors referred to in this guidance and the guidance included in the ACCOUNTING 01/20 communication previously issued by the Malta Institute of Accountants, such as the judgement of:

- whether the impacts of the COVID-19 pandemic are adjusting or non-adjusting events;
- whether an entity continues to be a going concern;
- whether it is virtually certain that an insurance claim will be received; or
- whether there is reasonable assurance that a government grant will be received.

IAS 1 also requires the disclosure of information about the assumptions made by a preparer about the future. Where estimates have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year, disclosure is also required of those other major sources of estimation uncertainty at the end of the reporting period. These may include, for example:

- weightings applied to different scenarios when estimating cash flows for the purposes of impairment testing or of fair valuation measurements;
- assumptions about how long it will take (under different scenarios) for businesses to recover from the pandemic, and the extent of such recovery under each scenario;
- assumptions and estimates about the effect that COVID-19 will have on counterparties' ability to settle their dues with the reporting entity; or
- estimates of the net realisable value of existing inventories, taking cognisance of demand levels and how those levels will change as measures are eased by the Maltese and foreign governments.

Once again, the above lists are indicative rather than exhaustive.

GAPSME is less specific about disclosures, however members are reminded of the Malta Institute of Accountants' illustrative financial statements for GAPSME preparers, which had been released upon the coming into force of GAPSME.

In addition, preparers should keep in mind that the Maltese Companies Act (Chapter

386 of the Laws of Malta) also requires certain disclosures in a company's directors' report. Other than those small companies that are exempted by the same Act from the preparation of a directors' report, all other companies must prepare a directors' report that must include, amongst others, a fair review of the development of the business of the company during the accounting period (and of its subsidiaries, if applicable) and of their position at the end of that period together with a description of the principal risks and uncertainties that they face. If necessary for a user's understanding thereof, the report must include both financial and, where appropriate, non-financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters.

Interim Financial Reporting

A key principle in IAS 34 is that an entity's last published full set of financial statements provides users with a full picture of an entity's statement of affairs as at the reporting date, and of its performance in the period then-ended. Accordingly, interim financial reports must provide their users with updates to the statements of affairs and of performance, but need not repeat all disclosures; focus need only be made on significant changes that have taken place since the last reporting period. Users are expected to read condensed interim financial reports in conjunction with the latest full set of financial statements.

Preparers of interim financial reports will need to consider what developments will require disclosure. Significant developments since the last reporting period may, under 'normal' circumstances, be few and far between, such as major capital expenditure or financing transactions, significant new contracts, business combinations, and other major developments. Preparers will now need to carefully consider the pandemic's implications.

For instance, disclosure may be required of the impact on the entity's financial statements, such as impacts on the carrying amount or fair value of its assets, or on its revenue recognition. Disclosure may also be required of updates to management's estimates, assumptions and judgements from those that were previously reported in the last financial report. Preparers will be required to reconsider the need to disclose matters which, due to a lack of significance at the time, were previously determined not to warrant disclosure.

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